

Sunderland City Council

Audit Strategy Memorandum Year ended 31 March 2013

February 2013

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Sunderland City Council
Audit Strategy Memorandum – Year ended 31 March 2013

Our reports are prepared in the context of the Audit Commission's 'Statement of responsibilities of auditors and audited bodies'. Reports and letters prepared by appointed auditors and addressed to members or officers are prepared for the sole use of the Council and we take no responsibility to any member or officer in their individual capacity or to any third party.

Mazars LLP is the UK firm of Mazars, an international advisory and accountancy group. Mazars LLP is registered by the Institute of Chartered Accountants in England and Wales.

1. Purpose of this document

This document sets out our audit plan in respect of the external audit of Sunderland City Council for the year ending 31 March 2013. This document forms the basis for discussion at the Audit and Governance Committee meeting on 22 March 2013.

The plan sets out our proposed audit approach and is prepared to assist you in fulfilling your governance responsibilities. The responsibilities of those charged with governance are defined as to oversee the strategic direction of the entity and obligations related to the accountability of the entity, including overseeing the financial reporting process.

Our communication with you is important in:

- Reaching a mutual understanding of the scope of the audit and the responsibilities of the auditor and those charged with governance;
- Sharing information to assist both the auditor and those charged with governance to fulfil their respective responsibilities;
- Providing to those charged with governance constructive observations arising from the audit process; and
- Ensuring as part of the two-way communication process that we, as external auditors, gain an understanding of the attitude and views of those charged with governance of the internal and external operational, financial, compliance and other risks facing the Council which might affect the audit, including the likelihood of those risks materialising and how they are monitored and managed.

2. Scope of engagement

We are appointed to perform the external audit of Sunderland City Council for the year to 31 March 2013. The scope of our engagement is laid out in the Audit Commission's Code of Audit Practice for Local Government bodies.

3. Respective responsibilities

The Audit Commission's Statement of Responsibilities of Auditors and of Audited Bodies sets out our respective responsibilities as the auditor and the audited body. The Audit Commission has issued a copy of the Statement to you.

The Statement summarises where the different responsibilities of auditors and of the audited body begin and end and we undertake our audit work to meet these responsibilities.

We comply with the statutory requirements governing audit work, in particular the:

- Audit Commission Act 1998; and
- Code of Audit Practice for Local Government bodies.

We, as auditors to Sunderland City Council, are responsible for forming and expressing an opinion on the financial statements and reaching a conclusion on the arrangements you have put in place to secure economy, efficiency and effectiveness in the use of your resources (the Value for Money conclusion).

We are also required to report on the consistency of your Whole Government Accounts L-Pack with the audited financial statements.

Our audit does not relieve management or the Audit and Governance Committee, as those charged with governance, of their responsibilities.

4. Independence

We have policies and procedures in place which are designed to ensure that we carry out our work with integrity, objectivity and independence. If at any time you have concerns or questions about our integrity, objectivity or independence please discuss these with the engagement lead.

We are required by the Audit and Assurance Council (previously the Auditing Practices Board - APB), which has issued ethical standards for auditors, to confirm we have complied with relevant ethical standards requirements regarding independence. This is to ensure our objectivity and independence is maintained.

Based on the information provided by you and our own internal procedures to safeguard our independence as auditors, we confirm that in our professional judgement there are no relationships between us and any of our related or subsidiary entities and you and your related entities creating any unacceptable threats to our independence within the regulatory or professional requirements governing us as your auditors. However, Members may wish to note that a member of my staff is married to a relatively junior member of the Council's staff and that arrangements are in place to ensure that independence is maintained.

We include in Appendix 1 our analysis of the principal threats to our objectivity and independence and the safeguards we have put in place.

5. Our audit approach

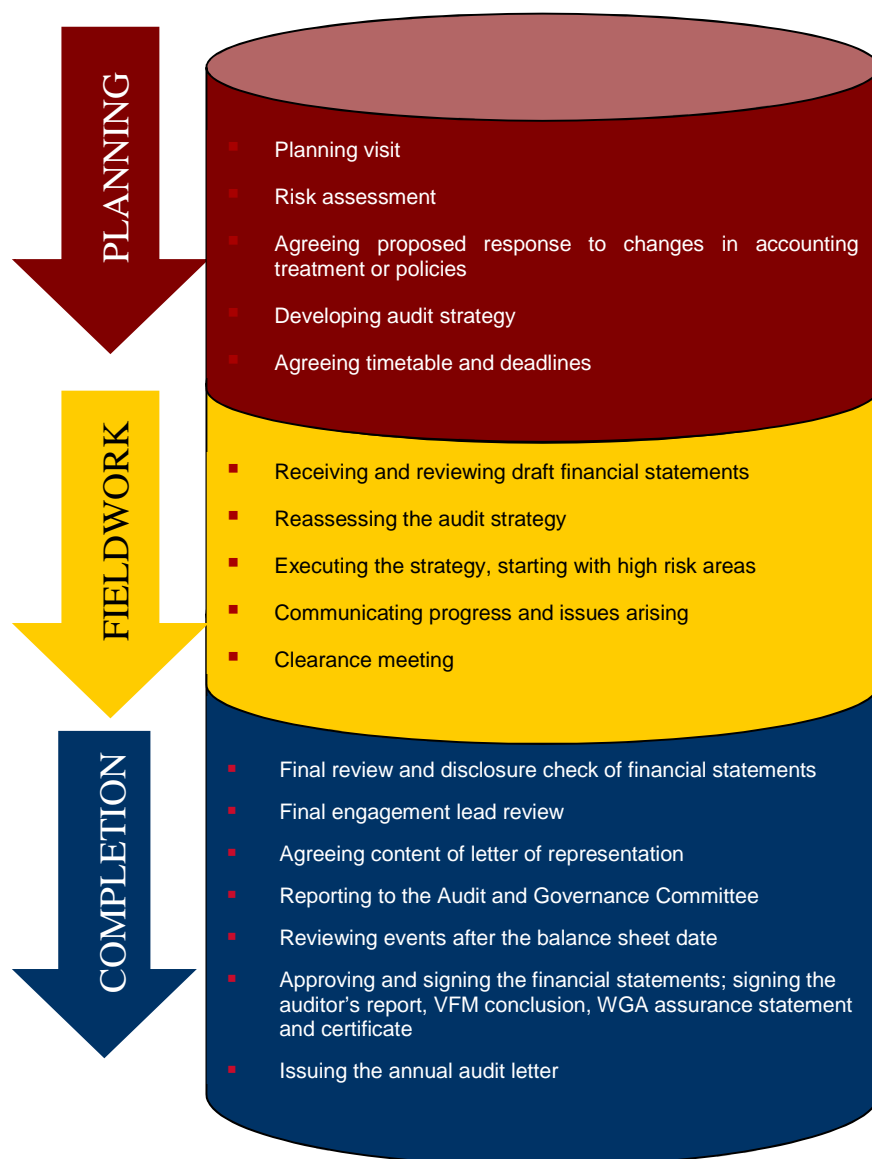
Our audit approach is designed to provide you with an audit that complies with all professional requirements.

Our audit of the financial statements will be conducted in accordance with International Standards of Auditing (UK and Ireland) issued by the Audit and Assurance Council (previously the APB). Our work is focussed on those aspects of your business which we consider to have a higher risk of material misstatement such as judgement and estimation, application of new accounting standards, changes of accounting policy, changes to operations or areas which have been found to contain material errors in the past. We raise and discuss these with you on a regular basis, not just at the time of the audit fieldwork. We expect to obtain appropriate evidence that we consider sufficient to enable us to draw reasonable conclusions therefrom and will use a combination of controls and substantive testing procedures as appropriate.

We plan our audit to have a reasonable expectation of detecting fraud where the potential effects would be material to the financial statements. We will consider the control procedures in place to prevent and detect fraud, whether there are any significant risks of fraud that may have a material impact on the financial statements and adapt our procedures accordingly. We also plan our audit to negate the risk of management over-riding controls by testing year-end journal entries and the major judgements and estimates that management make.

Our audit will be planned and performed so as to provide reasonable assurance that the financial statements are free of material misstatement and give a true and fair view.

The key stages of the audit are set out on the following page:



6. Reliance on internal audit

Where possible we will seek to utilise the work performed by internal audit to modify the nature, extent and timing of our audit procedures. We will meet with internal audit to discuss the progress and findings of their work prior to the commencement of our controls evaluation procedures.

Where we intend to rely on the work on internal audit, we will evaluate the work performed by your internal audit team and perform our own audit procedures to determine its adequacy for our audit.

7. Reliance on experts

We plan to place reliance on the following work of experts.

Area	Expert engaged by:	
	You	Ourselves
Asset valuation	Your in-house valuer	Central valuation trends report provided by the Audit Commission
Pension Fund liability and IAS 19 disclosures	AON Hewitt (the actuary of the Tyne and Wear Pension Fund)	Central assurance provided by Audit Commission, supplemented by in-house actuarial specialist where needed
Fair value disclosures	Sector	Central assurance provided by Audit Commission

8. Service organisations

We have not identified material entries in your financial statements where the Council is dependent on an external service organisation.

9. Group accounts

The Council currently does not produce group accounts and remains of the view that its group interests are not material. We will review these assumptions during the audit.

10. Significant events during the year impacting the audit

There have been some significant events during 2012/13, including the implementation of a severance scheme and the participation in an exercise to refinance Newcastle International Airport. The Council is also considering its position in relation to equal pay claims made against it.

These events and any further developments will be taken into account in our audit strategy for 2012/13.

The Council is also continuing to review services and is preparing for changes to council tax benefits and NNDR, as well as taking on public health responsibilities, in 2013/14.

11. Significant risks and key judgement areas

We met with the Director of Commercial and Corporate Services on 7 December 2012 and with the Chief Executive on 12 December 2012 as part of the audit planning process. We have also met with other key officers. During these meetings we discussed the risks that, in management’s opinion, you face. We have considered the impact on our audit risk. Set out below are the audit risks and the areas of management judgement to which we will pay particular attention in order to reduce the risk of material misstatement in the financial statements.

Significant audit risks	How we will address this risk
<p>Property, Plant and Equipment (PPE) PPE is subject to significant estimation uncertainty and is based on valuations provided by your in-house valuer.</p> <p>There is a risk that the valuation reported in the financial statements will be materially misstated due to:</p> <ul style="list-style-type: none"> • basis of valuation not in line with IFRS requirements; • incorrect assessments of the assets’ estimated useful lives; • incorrect asset classifications; • failure to recognise impairments or other significant changes in asset values; and • incorrect distinction between revenue and capital expenditure. <p>There is also a risk that the Council will fail to meet:</p> <ul style="list-style-type: none"> • IFRS and Code requirements; and • Statutory requirements for capital accounting and financing. 	<p>We will review the arrangements in place for:</p> <ul style="list-style-type: none"> • instructing the valuer and relying on their work; • maintaining an accurate fixed asset register; • establishing estimates of asset lives; and • identifying impairments. <p>We will also carry out tests of detail on capital transactions, balances and disclosures in the accounts.</p>

Significant audit risks	How we will address this risk
<p>Pension assets and liabilities</p> <p>There is considerable uncertainty on the estimate of the local government pension scheme liability. These are material and highly complex transactions, reliant to a large extent on information provided by third parties. Therefore there is an inherent risk that the financial statements may be materially misstated.</p>	<p>We will assess the work of the actuary and assess whether the disclosures in the financial statements properly reflect the actuary's report.</p> <p>We will liaise with the pension scheme auditor, in line with Audit Commission requirements.</p>
<p>Newcastle International Airport</p> <p>Together with its partners, the Council participated in a major refinancing of the debt of Newcastle International Airport during 2012/13. This will have a material impact on the disclosures in the financial statements. It is important to include an appropriate valuation for the airport in the 2012/13 accounts and reflect the loan refinancing transactions appropriately.</p>	<p>We will discuss the appropriate accounting treatment with officers to ensure that the financial statements present a true and fair view of these transactions.</p>
<p>Potential equal pay liabilities</p> <p>The Council has previously disclosed a contingent liability in relation to equal pay. Following the outcome of a number of employment tribunals, the Council is now exploring settlement of a number of equal pay cases. It is important to ensure that appropriate disclosures are made in the financial statements. There could be significant implications for the accounts if the Council needs to make specific provision for its potential liabilities.</p>	<p>We will continue to discuss with officers the accounting implications in relation to equal pay, including any post balance sheet events that may occur between the certification of the draft accounts in June 2013 and their approval in September 2013.</p>

Significant audit risks	How we will address this risk
<p>Group accounts</p> <p>The Council established Care and Support Sunderland Ltd following the collapse of Choices Care Ltd, and 2012/13 is its first full year of trading. The Council is also exploring a number of other options for alternative service delivery which include the potential for company formation. The Council is still of the view that it does not need to produce group accounts for 2012/13 on the grounds of quantitative and qualitative materiality.</p>	<p>We will review the Council’s assessment that it does not need to produce group accounts and keep this under review if any further alternative models for service delivery come to fruition.</p>
<p>Management override of controls</p> <p>In any organisation, management may be in a position to override the financial controls that it has in place. In the current economic climate, the Council may face pressure to deliver financial performance levels it has previously forecast.</p> <p>A breach of the controls over journal entries, accounting estimates and other accounts preparation processes may result in a material misstatement. I therefore consider management override of controls as a significant risk and adapt my audit procedures accordingly.</p>	<p>We have updated our understanding and evaluation of internal control processes and procedures as part of our audit planning, including completion of a fraud risk assessment. As part of this process we will be obtaining information from the Audit and Governance Committee and management on processes for assessing the risk of fraud in the financial statements and arrangements in place to identify, respond to and report fraud.</p> <p>We will complete audit testing of accounting estimates and journal entries in order to any material issues that I need to take into account in planning our audit and/or bring to your attention.</p>

Significant audit risks	How we will address this risk
<p>Risk of fraud in revenue and expenditure recognition</p> <p>There is a presumption under the ISAs that there is a significant risk of fraud in the timing of revenue recognition leading to the material misstatement of revenue overall. This is because revenue is an area of particular focus by users of financial statements and can be subject to judgements as to when the full risk and reward of the ownership of an asset has passed. For local authorities, the same risk applies to the recognition of expenditure.</p>	<p>We will test cut off to assess whether income and expenditure are included in the appropriate year. We will also carry out analytical review procedures.</p>

Areas of management judgement	How we will address this judgement
Property, plant and equipment Pension liabilities as assessed by the actuary Valuation of Newcastle International Airport Estimates in relation to potential equal pay liabilities	We will carry out the work identified in the significant risks table above.
Provisions are made for various known liabilities of uncertain timing, such as claims against the Council which will not be met from insurance	We will test material provisions against accounting requirements. We will assess whether the Council has provided for known liabilities.

12. Value for money

We are required to reach a conclusion on your arrangements to secure economy, efficiency and effectiveness in the use of your resources.

Our conclusion on your arrangements is based on two criteria, specified by the Audit Commission:

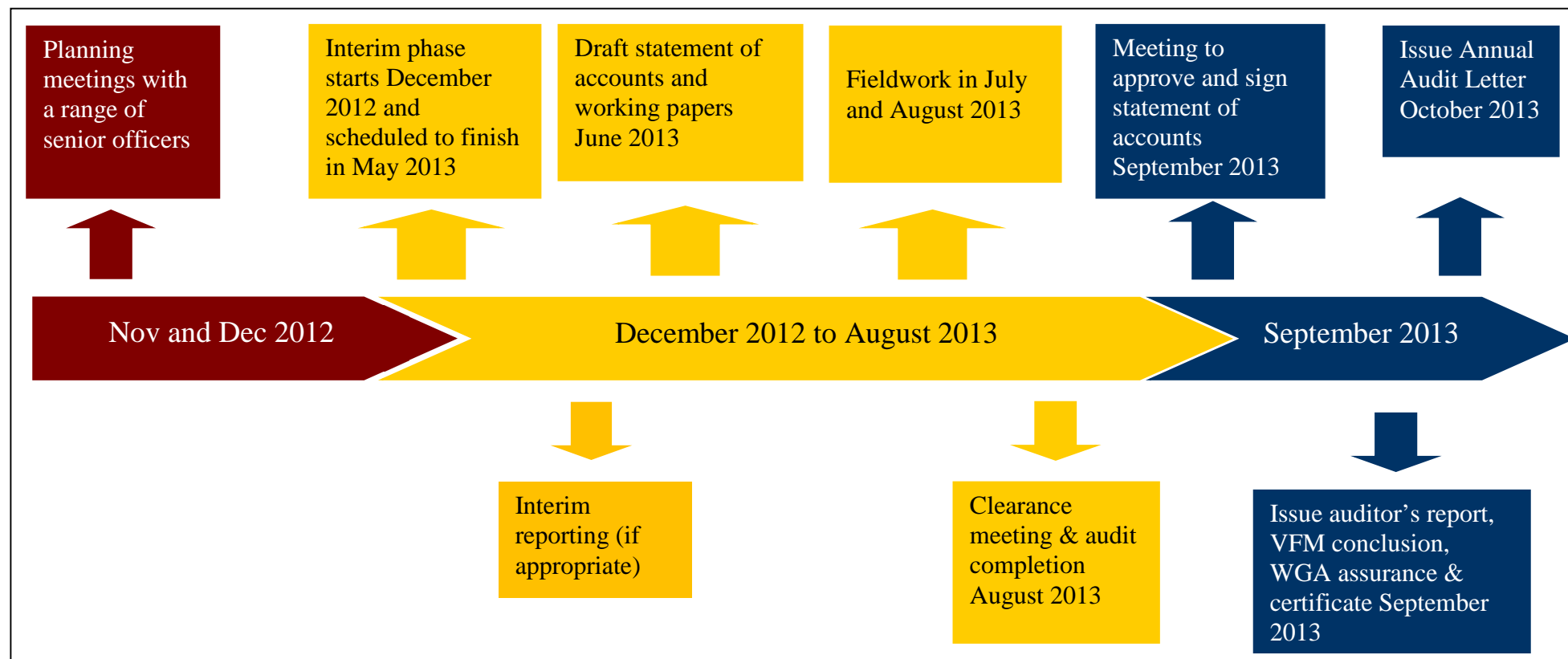
- securing financial resilience – focusing on whether you are managing your financial risks to secure a stable financial position for the foreseeable future; and
- challenging how you secure economy, efficiency and effectiveness – focusing on whether you are prioritising your resources within tighter budgets and the need to improve productivity and efficiency.

We have considered the risks that are relevant to our value for money conclusion and have identified the following significant risk that we will address through our work.

Risk identified	How we will address this risk
The Council faces financial pressures from reduced funding and continues to identify plans to deliver future savings. Without robust budgetary control and delivery of its action plans, the Council's financial resilience and service performance could deteriorate.	We will review budget monitoring and reporting, focusing on areas where action plans are in place to make savings and seek to minimise any adverse impact on service delivery. We will review the plans that are developed to deliver future savings.

13. Audit timeline

The table below sets out the timing of the key phases of our audit work. We will communicate with management throughout the audit process to facilitate a two way process of updates and identifying issues. We will continue to communicate outside of these dates to ensure that all parties understand developments and issues as they arise and to help in providing timely and appropriate solutions.



14. Fees for audit and other services

Audit fees

As communicated to you in our letter dated 15 November 2012 the Audit Commission has set a scale fee of £179,562.

Our audit fees, excluding VAT, for the audit are set out below:

Sunderland City Council	2012/13 fees (£)	2011/12 fees (£)
Audit	179,562	299,270
Certification work	16,050	36,945

Non-audit services

The Executive Director of Commercial and Corporate Services has commissioned a Review of Internal Audit for an additional fee of £3,500. There are no threats to our independence arising from this work.

Services provided by Mazars LLP associated entities

No audit or non-audit services have been provided by other entities associated with Mazars LLP to Sunderland City Council.

15. Proposed team

We know that you value a team who understands the environment you operate in and understands your systems, controls and has a good working relationship with your staff and internal auditors. Your team meets all these criteria.

Name and contact	Role	Experience and responsibilities
Steve Nicklin Tel: 0191 383 6300 Email: steve.nicklin@mazars.co.uk	Engagement Lead	Steve has over 30 years of external auditing experience of local government and has worked with you for a number of years. He is responsible for the overall delivery of the audit, including the quality of audit reports. Steve will sign the auditor's report and liaise with chief officers.
Gavin Barker Tel: 0191 383 6321 Email: gavin.barker@mazars.co.uk	Engagement Manager	Gavin will manage and coordinate the different parts of the audit and be the key point of contact for the officers producing the financial statements and those involved with the value for money assessment.
Cathie Eddowes Tel: 0191 383 6310 Email: catherine.eddowes@mazars.co.uk	Team Leader	Cathie has a number of years post qualification experience and will lead the onsite delivery of the audit of the financial statements and grant claims work.
Suresh Patel Tel: 020 7063 4609 Email: suresh.patel@mazars.co.uk	Independent Partner	Suresh is Mazars' public sector lead within the standards and risk management team.

Appendices

Appendix 1 – Independence

Independence is an ongoing consideration and as such we monitor it throughout the audit process. The principal types of threats to the auditor's objectivity and independence are:

- self-interest threat - exists when the auditor has financial or other interests which might cause the auditor to be reluctant to take actions that would be adverse to the interests of the audit firm or any individual in a position to influence the conduct or outcome of the audit;
- self-review threat - exists when the results of a non-audit service performed by the engagement team or by others within the audit firm are reflected in the amounts included or disclosed in the financial statements;
- management threat - exists when the audit firm undertakes work that involves making judgments and taking decisions that are properly the responsibility of management;
- advocacy threat - exists when the audit firm undertakes work that involves acting as an advocate for an audited entity and supporting a position taken by management in an adversarial context;
- familiarity (or trust) threat – exists when the auditors are predisposed to accept or are insufficiently questioning of the client's point of view (for example, where they develop close personal relationships with client personnel through long association with the client); and
- intimidation threat – exists when the auditor's conduct is influenced by fear or threats (for example, when they encounter an aggressive and dominating individual).

Prior to the provision of any non-audit services the engagement partner will undertake appropriate procedures to consider and fully assess the impact that providing the service may have on our auditor independence.

We have not identified any threats to our independence which require identification of safeguards.

However, Members may wish to note that a member of my staff is married to a relatively junior member of the Council's staff and that arrangements are in place to ensure that independence is maintained.

Appendix 2 – Materiality

'Materiality' is an expression of the relative significance or importance of a particular matter in the context of financial statements as a whole.

Misstatements in financial statements are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Judgements on materiality are made in light of surrounding circumstances and are affected by the size and nature of a misstatement, or a combination of both. Judgements about materiality are based on consideration of the common financial information needs of users as a group and not on specific individual users.

The assessment of what is material is a matter of professional judgement and is affected by our perception of the financial information needs of the users of the financial statements. It is reasonable for us to assume that users:

- have a reasonable knowledge of business, economic activities and accounts;
- have a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented and audited to levels of materiality;
- recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgement and the consideration of future events; and
- will make reasonable economic decisions on the basis of the information in the financial statements.

We will consider materiality whilst planning and performing our audit.

Whilst planning, we will make judgements about the size of misstatements which we will consider to be material and which will provide a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

The materiality determined at the planning stage does not necessarily establish an amount below which uncorrected misstatements, either individually or in aggregate, will be considered as immaterial.

We will revise materiality for the financial statements as our audit progresses should we become aware of information that would have caused us to determine a different amount had we been aware of that information at the planning stage.

We will include in our Audit Completion Report all unadjusted errors we have identified above those which are clearly trivial.

Appendix 3 – Required communication

ISA 260 ‘Communication With Those Charged With Governance’ and ISA 265 ‘Communicating Deficiencies In Internal Control To Those Charged With Governance And Management’ require the auditor to communicate a number of matters with those charged with governance. These matters are set out below along with our proposed approach. You are required to ensure that all points listed below are communicated to those charged with governance.

Required communication	When and how we will communicate
<p>Respective responsibilities of auditor and those charged with governance. Our responsibility for performing the audit in accordance with ISAs (UK and Ireland), which is directed towards forming and expressing an opinion on the financial statements. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.</p>	<p>Section 3 of this report and the Audit Commission’s Statement of Responsibilities of Auditors and of Audited Bodies.</p>
<p>Communication of the planned scope and timing of the audit.</p> <p>Matters communicated include:</p> <ul style="list-style-type: none"> ▪ Significant audit risks and how we will address them; ▪ Our approach to internal control relevant to the audit; ▪ The application of the concept of materiality in the context of an audit; ▪ Our use of the work of internal audit; ▪ Your approach to internal control and how you oversee the effectiveness of internal control procedures; ▪ The attitude, awareness and action of those charged with governance concerning the detection or possibility of fraud; and ▪ Your response to new accounting standards, corporate governance practices and related matters. 	<p>Included in this document.</p> <p>These matters were discussed at the planning meeting and responses incorporated into this document as appropriate.</p>

Required communication	When and how we will communicate
<p>Our views on significant qualitative aspect of accounting practices including accounting policies, accounting estimates and financial statement disclosures.</p> <p>When applicable, why we consider a significant accounting practice not to be appropriate to the entity.</p>	<p>We will communicate these in our Audit Completion Report, orally as they arise, and at the final Audit and Governance Committee meeting.</p> <p>Depending on the extent of the issue, either orally at the final Audit and Governance Committee, in our Audit Completion Report or immediately we become aware of the issue.</p>
<p>Significant difficulties, if any, encountered during the audit.</p> <p>Significant difficulties encountered during the audit may include such matters as:</p> <ul style="list-style-type: none"> ▪ Significant delays in management providing required information; ▪ An unnecessarily brief time within which to complete the audit; ▪ Extensive unexpected effort required to obtain sufficient appropriate audit evidence; ▪ The unavailability of expected information; ▪ Restrictions imposed on the auditor by management; and ▪ Management’s unwillingness to make or extend its assessment of the entity’s ability to continue as a going concern. ▪ 	<p>We will communicate these in our Audit Completion Report, orally as they arise, and at the final Audit and Governance Committee meeting.</p>
<p>Details of significant matters discussed with, or subject to correspondence with management.</p>	<p>We will communicate these in our Audit Completion Report, orally as they arise, and at the final Audit and Governance Committee meeting.</p>
<p>Details of written representations we require for our audit.</p>	<p>We will communicate this in our Audit Completion Report.</p>

Required communication	When and how we will communicate
<p>Any other matters which we consider to be significant to the oversight of the financial reporting process.</p> <p>Other significant matters arising from the audit that are directly relevant to those charged with governance in overseeing the financial reporting process may include such matters as material misstatements of fact or material inconsistencies in information accompanying the audited financial statements that have been corrected.</p>	<p>As any matters arise which we consider should be communicated to you and within the Audit Completion Report.</p>
<p>Statement that the engagement team and the firm have complied with relevant ethical requirements regarding independence.</p> <p>Written disclosure of relationships which have a bearing on our independence and safeguards we have put in place, details of non audit services provided and written confirmation of our independence.</p>	<p>Section 4 and Appendix 1 of this document and as any new matters arise.</p>
<p>Form, timing and general content of communications.</p>	<p>We will issue our Audit Completion Report which will conclude upon our audit and the issues presented in this document. Should you require us to communicate in a different way please inform us of your preferred method.</p>

Required communication	When and how we will communicate
<p>Our evaluation of the adequacy of the communication process between ourselves and those charged with governance. This may include observations on appropriateness and timing of action taken by you in response to matters we have raised, the openness of your communication with us, your willingness and capacity to meet with us without management being present, your opportunity to fully comprehend matters we have raised, the extent to which you probe issues raised and our recommendations, any communications we have had in establishing with you the form, timing and general content of communications, your awareness of how our discussions impact on your governance and management responsibilities and whether your communication with us meets legal and regulatory requirements.</p>	<p>Should we consider it necessary to raise any of these issues, we will consider the most appropriate method and the most appropriate person. The nature of our observation will determine the method and timing of our communication.</p> <p>We may consider that any inadequacy in the communication process is indicative of an unsatisfactory control environment and increase our assessment of audit risk. We will also consider whether we need to reassess our audit strategy. We will discuss with you any additional procedures we consider necessary as a result of these observations.</p> <p>If we consider the communication between you and us to be inadequate and we are unable to agree additional procedures which we consider necessary, we may modify our audit opinion, obtain legal advice, discuss with other third parties as we consider appropriate or may, if permitted under applicable law or regulation, withdraw from the engagement.</p>

Required communication	When and how we will communicate
Any significant deficiencies in internal control that we have identified during the audit.	<p>We will communicate these to you in our Audit Completion Report. Should it be appropriate, we will discuss significant deficiencies with management as they arise.</p> <p>Our written communication will include a description of the deficiencies with sufficient explanation for you to understand the context of the deficiency and an explanation of the potential effects.</p> <p>We are required to communicate all significant deficiencies to you, irrespective of whether you are already aware of them or have chosen not to take remedial action for cost or other reasons. We will continue to communicate deficiencies previously communicated to you until remedial action has been taken. We will consider whether failure to act, or lack of rational explanation itself represents a significant deficiency.</p>
Other deficiencies in internal control that we have identified during the audit.	<p>We will consider whether other deficiencies should be reported to you, taking into account the likelihood and potential magnitude of misstatements that may arise. We will also determine whether we report these to you orally or in writing.</p>