

2010/11 opinion audit - changes you can expect to see

Hampshire Fire and Rescue Authority

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The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.



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Introduction

1 In my audit plan I advised you that my work for 2010/11 would be influenced by;

- The requirements of 'clarified' international auditing standards; and,
- The Audit Commission's new approach to the value for money conclusion.

2 This report sets out a broad framework of how my audit for 2010/11 may differ from those of previous periods. I hope assists management and Those Charged with Governance in understanding the revised nature and scope of my work.

3 The fees for this work continue to be determined by the Audit Commission under the previous arrangements. There has been no formal change to the national scale of fees for public sector audits for 2010/11. I do not therefore propose to adjust locally your agreed fees at this stage.

4 I will however continue to review this in light of any decisions made by the Audit Commission, or by me under my local risk assessment process.

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Changes to my value for money work

5 The Commission has introduced a new, more targeted approach to my local VFM audit work. This approach is based on the principles that it should:

- enable auditors to fulfil their responsibility under the Audit Commission Act 1998 about an audited body's arrangements to secure economy, efficiency and effectiveness;
- be sharper, more focused and potentially less costly than the existing use of resources assessment; and
- apply proportionately to reflect the size, capacity and performance of different types of audited body and, as far as possible, consistently across all sectors of the Commission's regime.

6 For 2010/11, the scope of my work is confined to 2 criteria:

- Do you have proper arrangements in place for securing financial resilience?; and
- Do you have proper arrangements for challenging how you secure economy, efficiency, and effectiveness?

7 The impact of this on my audit is summarised in the table below:

Financial resilience	Challenging value for money
The organisation has proper arrangements in place for securing financial resilience.	The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.
What I may consider:	
Do you have robust financial systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables you to continue to operate for the foreseeable future.	Are you prioritising resources within tighter budgets, for example by achieving cost reductions and improving efficiency and productivity.
Potential work to support my VFM conclusion:	
I may undertake risk-based work focusing on the robustness of your arrangements relating to financial governance, strategic financial	I may undertake risk-based work on the robustness of your arrangements for prioritising resources and improving

planning, and financial control.

productivity and efficiency.

This will be informed by the results of previous audit work, the Commission's guidance for auditors and tools provided by the Commission.

This will be informed by the results of previous audit work, and the work of other inspectorates or review agencies.

Risk-based approach

8 I will decide the exact local programme of VFM audit work based on my audit risk assessment, informed by these criteria and my statutory responsibilities. I am no longer

9 required to provide an annual scored judgement about my local VFM audit work. Instead I will report the results of all my local VFM audit work and the key messages for the Authority in my annual report to those charged with governance and in my annual audit letter.

10 There are clearly a number of risks that are significant in the national context. I will consider the following, together with any local risks identified through my ongoing planning work as part of scoping my VFM work;

- Spending Review;
- Maintaining services and effectiveness with reduced funding; and,
- New public services transparency framework

Spending Review (SR)

11 The impact of the SR on individual audited bodies for 2011/12 was announced in early December, when the government published the provisional local government finance settlement. The impact on the Fire Authority of the 2011/12 settlement is less than anticipated and within the range of potential scenarios considered as part of your medium term financial planning.

Maintaining services and effectiveness with reduced funding

12 The coalition government reduced in-year funding for local government bodies in 2010/11 by £1.166 billion (£805 million in cuts to revenue and £360.9 million to capital specific grants). These measures will have a significant impact on local government bodies ability to deliver their original 2010/11 budgets. These issues are relevant to auditors' work on the specified criteria for securing financial resilience and challenging arrangements for securing economy, efficiency, and effectiveness.

13 The expected scale of the budget reductions for the SR period will have a significant impact. For individual bodies the impact will depend on the:

- grant funding and the timing of reductions required;

- extent to which the body relies on grant as opposed to other sources of income such as council tax and fees and charges; and
- readiness and capacity to manage change and achieve savings.

New public services transparency framework

14 Plans for this future framework are still emerging; however the principles underpinning it are clear. These are to turn accountability ‘on its head’ by making local government bodies more accountable to local people rather than to central government. Bodies will be required to be more open and transparent in their operations and performance so local people have the information they need to hold them to account. Parts of the new framework are expected to be published soon after the SR.

Defining the new terms

What do we mean by proper arrangements for securing financial resilience?

15 For my purposes, I see this as referring to arrangements for,

- Financial governance - The quality of financial governance and leadership within an organisation is critical in meeting the financial management challenges and for securing financial resilience. Good basic systems, processes, and controls are important, but it is the overall financial culture that makes the difference.
- Financial planning - Organisations should set the budget in the context of a longer-term financial strategy and a medium-term financial plan (MTFP) covering for example, a three-to five-year horizon. The MTFP needs to be realistic. Assumptions around inflation, income levels, demographics, and future demand for services need to be modelled and based on reasonable predictions.
- Financial control - Authorities need to manage within their budget. Authorities therefore need to challenge their budget monitoring and reporting arrangements to ensure they are fit-for-purpose, and that they can respond to the even greater need to demonstrate value for money and achieve efficiencies.

What do we mean by securing economy, efficiency, and effectiveness?

16 I see this as the arrangements the organisation has to prioritise its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

17 All public bodies will now have to make difficult decisions about priorities, and find more efficient and innovative ways of delivering their responsibilities. Organisations which have proper arrangements for challenging how they secure economy, efficiency, and effectiveness are more likely to be financially resilient and fit for the future.

18 This includes:

- Prioritising resources - making sustainable cost reductions, taking a strategic approach to challenging all areas of spend, considering how spending matches the priorities of the organisation and the needs of the people it serves.
- Improving efficiency and productivity - Managing the impact of reducing government funding on local public services, organisations and making the best possible use of the resources available to them.

In summary:

- My VFM conclusion will be focused on local risk; there is no prescribed national coverage.
- The new framework allows me to exercise professional judgement in the extent of work I undertake. If I do not identify any significant risks to my conclusion, I do not have to undertake any specific work.
- There are 2 criteria - financial resilience and arrangements to challenge how you secure value for money.
- There are no scores or checklists for this work.

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Changes to my opinion audit

19 As your appointed auditor, the audit of your financial statements is governed by a framework established by International Standards on Auditing (ISAs) and the Audit Commission's code of audit practice. These standards prescribe the basic principles and essential procedures, with the related guidance, which govern my professional conduct.

20 As with all guidance and frameworks, auditing standards are often changed and updated, often in a piecemeal fashion. However, in 2009 the auditing professional completed a comprehensive project to improve the clarity of all the ISAs. This is known as the Clarity Project.

21 One of the main objectives of the Clarity Project was to promote greater consistency of application between auditors. This has been done by reducing the ambiguity within existing ISAs and improving their overall readability and understandability.

22 The new clarified framework will apply to my audit of your 2010/11 financial statements. Because of the new standards, you can expect to see some changes in the way my audit team delivers your audit and the information they request from you. The purpose of this document is to highlight to you the main changes and how they will affect you.

23 In summary the main changes you will see relate to:

- Related Party Transactions;
- Accounting Estimates;
- Reporting deficiencies in internal control.

Impact of the these changes

Related Party Transactions

24 ISA (UK&I) 550 (Related parties) requires me to review your procedures for identifying related party transactions and obtain an understanding of the controls that you have established to identify such transactions.

25 The new clarified standard places more emphasis on a risk based approach to this work and tries to improve the auditor's identification of undisclosed related parties.

26 I will be required to consider related party relationships and transactions in terms of possible fraud or error and to obtain a greater understanding of controls you have established to regulate transactions with related parties, if any.

Accounting Estimates

27 ISA 540 on auditing accounting estimates also covers fair value estimates and takes a more rigorous approach, based also on prescribed audit procedures when management estimates are considered.

28 ISA (UK&I) 540 (Auditing Accounting Estimates, Including Fair Value Accounting Estimates, And Related Disclosures) requires me to look at your accounting estimates in detail.

29 As part of my audit I will seek a list of these from you in advance of my audit commencing. I will need to know in particular:

- the process you use to make your accounting estimates;
- the controls you use to identify them;
- whether you use an expert to assist you in making the accounting estimates;
- whether any alternative estimates have been discussed and why they have been rejected;
- how you assess the degree of estimation uncertainty (this is the level of uncertainty arising because the estimate cannot be precise or exact) ;
and
- the prior year's accounting estimates outcomes, and whether there has been a change in the method of calculation for the current year.

Deficiencies in internal control

30 ISA (UK&I) 265 (Communicating Deficiencies in Internal Control to Those Charged with Governance and Management) is a new standard. It is basically an extension to ISA 260 and acknowledges that those charged with governance and management may consist of two separate groups of individual(s) – this is particularly relevant in the public sector.

31 ISA 265 requires me to consider the possibility that weaknesses identified during the course of my audit may be brought to the attention of management OR those charged with governance, depending on the nature of the weakness or non-existence of an internal control.

32 If I identify a deficiency in any of your internal controls during the audit, I will undertake further audit testing to decide whether the deficiency is significant. If I decide the deficiency is significant, I will report it in writing to your Governance Committee (for the Fire Authority) as those charged with governance.