

AUDIT COMMITTEE

29 June 2011

EXTERNAL AUDIT PLAN 2010/11

REPORT OF HEAD OF FINANCE

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RECENT REFERENCES:

[PS410](#): External Audit Opinion Plan 2009/10 & Annual Audit Fees for 2010/11, 14 June 2010

EXECUTIVE SUMMARY:

The Audit Commission have now presented their Audit Plan for 2010/11 (attached). This sets out the work proposed to be undertaken for the audit of the financial statements and the value for money conclusion 2010/11. The documents have been discussed with officers prior to presentation and are fairly self-explanatory.

Representatives of the Audit Commission will attend the meeting to present their proposals and provide any points of clarification.

The fee for the audit is £130,200 which is as previously advised.

RECOMMENDATION:

That the Audit Committee considers the attached Audit Plan and takes the opportunity to raise any points of clarification or concerns with the Auditors who will be present at the meeting.

# Audit plan

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Winchester City Council

Audit 2010/11

**The Audit Commission is a public corporation set up in 1983 to protect the public purse.**

**The Commission appoints auditors to councils, NHS bodies (excluding NHS Foundation trusts), police authorities and other local public services in England, and oversees their work. The auditors we appoint are either Audit Commission employees (our in-house Audit Practice) or one of the private audit firms. Our Audit Practice also audits NHS foundation trusts under separate arrangements.**

**We also help public bodies manage the financial challenges they face by providing authoritative, unbiased, evidence-based analysis and advice.**

# Contents

<b>Introduction</b> .....	<b>2</b>
<b>Responsibilities</b> .....	<b>3</b>
<b>Fee for the audit</b> .....	<b>4</b>
Specific actions the Council could take to reduce its audit fees .....	4
<b>Auditors report on the financial statements</b> .....	<b>5</b>
Materiality .....	5
Identifying opinion audit risks.....	5
<b>Identification of specific risks</b> .....	<b>6</b>
<b>Testing strategy</b> .....	<b>7</b>
<b>Value for money conclusion</b> .....	<b>9</b>
<b>Key milestones and deadlines</b> .....	<b>10</b>
<b>The audit team</b> .....	<b>11</b>
Independence and objectivity .....	11
Meetings .....	11
Quality of service .....	12
Planned outputs.....	12
<b>Appendix 1 Basis for fee</b> .....	<b>13</b>
<b>Appendix 2 Independence and objectivity</b> .....	<b>14</b>
<b>Appendix 3 Working together</b> .....	<b>16</b>
<b>Appendix 4 Glossary</b> .....	<b>17</b>

# Introduction

## **This plan sets out the audit work that I propose to undertake for the audit of financial statements and the value for money conclusion 2010/11.**

1 The plan is based on the Audit Commission's risk-based approach to audit planning. It reflects:

- audit work specified by the Audit Commission for 2010/11;
- current national risks relevant to your local circumstances; and
- your local risks.

2 It also explains:

- the changes to our approach as a result of applying the revised International Standards on Auditing (ISAs); and
- the extra work we will be doing because of the transition to accounts based on International Financial Reporting Standards (IFRSs).

# Responsibilities

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

**3** The Statement summarises where the different responsibilities of auditors and of the audited body begin and end. I undertake my audit work to meet the auditor's responsibilities.

**4** I comply with the statutory requirements governing our audit work, in particular:

- the Audit Commission Act 1998; and
- the Code of Audit Practice.

**5** I plan and carry out my audit work in accordance with the Audit Commission's approach, which meets the requirements of the International Standards for Auditing (UK and Ireland).

## Fee for the audit

### **The fee for the audit is £130,200, as stated in my letter of 9 April 2010.**

6 The fee for 2010/11 is £130,200 which is 4.4 per cent less than the fee for 2009/10 £136,200. The Audit Commission scale fee for a district council with Winchester City Council's gross expenditure is £121,540. The fee proposed for 2010/11 is 7 per cent above the scale fee and is within the normal variation specified by the Commission. This reflects the increased risk that are specific to the audit of your financial statements arising from your decision to implement new financial systems during 2010/11 and the continuing control weaknesses in respect of the payroll system and accounts payable.

7 The Commission is currently consulting on fee changes and is proposing a rebate of 1.5 per cent of this fee (£1,823) following the abolition of CAA.

8 In setting the fee, I have assumed that:

- the level of risk for the audit of accounts is consistent with that for 2009/10;
- good quality, accurate working papers are available at the start of the financial statements audit;
- the Council will supply good quality working papers to support the restatement of 2009/10 balances to comply with International Financial Reporting Standards (IFRS); and
- Internal Audit undertakes appropriate work on all material systems and this is available for our review by 4 March 2011.

9 Where these assumptions are not met, I will be required to undertake additional work which is likely to result in an increased audit fee. Where this is the case, I will discuss this first with the Head of Finance and Section 151 Officer and will issue supplements to the plan to record any revisions to the risk and the impact on the fee.

10 Further information on the basis for the fee is set out in appendix 1.

### **Specific actions the Council could take to reduce its audit fees**

11 The Audit Commission requires its auditors to inform audited bodies of specific actions it could take to reduce its audit fees. As in previous years, I will work with staff to identify any specific actions the Council could take and to provide continuing audit support.

# Auditors report on the financial statements

## **I will carry out the audit of the financial statements in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB).**

**12** I am required to issue an audit report giving my opinion on whether the accounts give a true and fair view of the financial position of the Council as at 31 March 2011.

### **Materiality**

**13** I will apply the concept of materiality in both planning and performing the audit, in evaluating the effect of any identified misstatements, and in forming my opinion.

### **Identifying opinion audit risks**

**14** I need to understand the audited body fully, to identify any risk of material misstatement (whether because of fraud or error) in the financial statements. I do this by:

- identifying the business risks facing the Council, including assessing your own risk management arrangements;
- considering the financial performance of the Council;
- assessing internal control - including reviewing the control environment, the IT control environment and Internal Audit; and
- assessing the risk of material misstatement arising from the activities and controls within the Council information systems.



# Identification of specific risks

**I have considered the additional risks that are appropriate to the current opinion audit and have set these out below.**

Table 1: **Specific risks**

Specific opinion risks identified

Risk area	Audit response
Transition to IFRS compliant accounts	<ul style="list-style-type: none"> <li>■ I will review the restated accounts and comparatives for 2009/10 and the revised accounting policies.</li> <li>■ I will pay particular attention to the higher risk areas of Property, Plant and Equipment (especially leases, contracts with embedded leases and component accounting), segmental reporting and accruals for employee benefits.</li> </ul>
Financial pressures	<ul style="list-style-type: none"> <li>■ I will consider how the Council is responding to the increasing financial pressures and whether these are unduly influencing the reporting of financial results.</li> </ul>
New accounting systems	<ul style="list-style-type: none"> <li>■ I will need to carryout additional work in order to address the increased risk arising from the implementation of new financial systems in October 2010. This will include the documentation of the new systems; additional testing of the transfer of data to the new systems and the new arrangements for the production of the accounts from the new financial ledger.</li> <li>■ My IT risk assessment will be completed by a senior IT Risk Assurance Manager because of the increased risk arising from the implementation of new financial systems in 2010/11.</li> </ul>
Capacity within the Finance Section	<ul style="list-style-type: none"> <li>■ I will consider the impact on my audit of the changes in the staffing of the Finance Team and their capacity to deal with the implementation of IFRs and other competing demands.</li> </ul>
Control weaknesses in the payroll and accounts payable systems	<ul style="list-style-type: none"> <li>■ I will review the Council's progress in making improvements to the payroll and accounts payable systems during 2010/11.</li> </ul>

# Testing strategy

**Based on risks identified above I will produce a testing strategy which will consist of testing key controls and substantive testing of transaction streams and material account balances at the year end.**

**15** I can carry out the testing both before and after the draft financial statements have been produced (pre and post-statement testing).

**16** Wherever possible, I will complete some substantive testing before the financial statements are available for audit. This year that work will comprise mainly my assessment of your revised accounting policies and restated prior-year balance sheets associated with the transition to IFRS-based accounting, and I plan to do this in March 2011.

**17** Wherever possible, I will seek to rely on the work of Internal Audit to help meet my responsibilities. For 2010/11, I expect to be able to use the systems documentation that will have been produced by Internal Audit and the results of the following pieces of work.

- Main Accounting System.
- Accounts receivable.
- Accounts payable.

**18** I will also seek to rely on the work of other auditors and experts, as appropriate, to meet my responsibilities. For 2010/11, I plan to rely on the work of other auditors in respect of pensions - the auditors of Hampshire County Council.

**19** I also plan to rely on the work of experts in the following areas.

- Property valuations - Council appointed valuer.
- Pensions liabilities - Pension Fund actuaries.

## Clarified ISAs

**20** In 2009 the auditing profession completed a comprehensive project to enhance the clarity of all the ISAs. This is known as the Clarity Project. One of its main objectives 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.

**21** 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.

**22** The main changes you will see are as follows.

- Journals - ISA (UK&I) 330 (The Auditor's response to assessed risks) requires me to review all material year-end adjustment journals. I can do this by using interrogation tools such as CAATs (Computer aided audit techniques), IDEA software or excel, depending on the compatibility of your general ledger software. My Audit Manager will discuss a suitable approach to this work soon.
- Related Party Transactions - 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. I will also review minutes and correspondence for evidence of related party transactions and carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate.
- Accounting Estimates - 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. As part of my audit I will request a list of these from you. 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.
- Reporting deficiencies in internal control - ISA (UK&I) 265 (Communicating Deficiencies in Internal Control to Those Charged with Governance and Management) is a new standard. 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 Audit Committee, as those charged with governance.

# Value for money conclusion

## **I am required to give a statutory VFM conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.**

**23** I will base my VFM Conclusion for 2010/11 on two criteria, specified by the Audit Commission, which cover your arrangements for:

- securing financial resilience – focusing on whether the Council is managing its financial risks to secure a stable financial position for the foreseeable future; and
- challenging how the Council secures economy, efficiency and effectiveness – focusing on whether the Council is prioritising its resources within tighter budgets and improving productivity and efficiency.

**24** I am planning a programme of VFM audit work based on my risk assessment. I will base this on:

- capturing what we know already from last year's work, VFM profiles, continuing reviews of minutes and discussions with officers;
- considering sector specific risks, including
- the government's spending review,
- maintaining essential services and effectiveness with reduced funding,
- the new public services transparency framework, and
- sector self-regulation and improvement.

**25** In addition, we will consider how the Council is addressing issues I raised in my Annual Audit Letter last year.

**26** I will carry out more project work only where I would not be able to arrive at a VFM conclusion without it. I will report the results of my work in my Annual Governance Report and Annual Audit Letter.

## Key milestones and deadlines

**The Council is required to prepare the financial statements by 30 June 2011. I am required to complete the audit and issue the opinion and value for money conclusion by 30 September 2011.**

**27** The key stages in producing and auditing the financial statements are in table 2.

**28** I will agree with you a schedule of working papers required to support the entries in the financial statements. The agreed fee is dependent on the timely receipt of accurate working papers.

**29** Each week during the periods that we are at Council's offices during the audit, the audit team will meet with the key contact and review the status of all queries. I can arrange meetings at a different frequency depending on the need and the number of issues arising.

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Table 2: **Proposed timetable**

Activity	Date
Control and early substantive testing	March and April 2011
Receipt and audit of re-stated 2009/10 balance sheet	March 2011
Receipt of accounts	30 June 2011
Receipt of supporting working papers for the accounts	30 July 2011 [Date to be confirmed]
Start of detailed testing	August 2011 [Date to be confirmed]
Progress meetings	Weekly or as required
Present report to those charged with governance at the Audit Committee	19 September 2011
Issue opinion and value for money conclusion	By 30 September 2011

## The audit team

**Table 3 shows the key members of the audit team for the 2010/11 audit.**

Table 3: **Audit team**

Name	Contact details	Responsibilities
Patrick Jarvis District Auditor	<a href="mailto:p-jarvis@audit-commission.gov.uk">p-jarvis@audit-commission.gov.uk</a> 0844 798 8986	Responsible for the overall delivery of the audit including the quality of outputs, signing the opinion and conclusion, and liaison with the Chief Executive.
Mike Bowers Audit Manager	<a href="mailto:m-bowers@audit-commission.gov.uk">m-bowers@audit-commission.gov.uk</a> 07812 350518	Manages and coordinates the different parts of the audit work. Key point of contact for the Head of Finance.
Sara Rowntree Team Leader	<a href="mailto:s-rowntree@audit-commission.gov.uk">s-rowntree@audit-commission.gov.uk</a> 0777 957 3133	Responsible for leading the opinion audit and day-to-day liaison with the Finance Team.

### Independence and objectivity

**30** I am not aware of any relationships that may affect the independence and objectivity of the District Auditor and the audit staff, which I am required by auditing and ethical standards to communicate to you.

**31** I comply with the ethical standards issued by the APB and with the Commission's requirements on independence and objectivity as summarised in appendix 2.

### Meetings

**32** The audit team will ensure we have knowledge of your issues to inform our risk-based audit through regular liaison with key officers. Our proposals are set out in appendix 3.

## Quality of service

**33** I aim to provide you with a fully satisfactory audit service. If, however, you are unable to deal with any difficulty through me and my team please contact Chris Westwood, Director of Professional Practice, Audit Practice, Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ ([c-westwood@audit-commission.gov.uk](mailto:c-westwood@audit-commission.gov.uk)) who will look into any complaint promptly and to do what he can to resolve the position.

**34** If you are still not satisfied you may of course take up the matter with the Audit Commission's Complaints Investigation Officer (The Audit Commission, Westward House, Lime Kiln Close, Stoke Gifford, Bristol BS34 8SR).

## Planned outputs

**35** My team will discuss and agree reports with the right officers before issuing them to the Audit Committee.

Table 4: **Planned outputs**

Planned output	Indicative date
Interim audit memorandum (if necessary)	30 June 2011
Annual governance report	19 September 2011
Auditor's report giving an opinion on the financial statements	30 September 2011
Value for money conclusion	30 September 2011
Final accounts memorandum [if necessary]	30 November 2011
Annual audit letter	31 October 2011

# Appendix 1 Basis for fee

The Audit Commission is committed to targeting its work where it will have the greatest effect, based on assessments of risk and performance. This means planning work to address areas of risk relevant to our audit responsibilities and reflecting this in the audit fees.

## Assumptions

In setting the fee, I have assumed the following.

- The risk for the audit of the financial statements is not significantly different from that identified for 2009/10.
- The fee for the value for money conclusion is the same as for 2009/10 (subject to the changes being consulted on by the Audit Commission to provide rebates on the 2010/11 fees to recognise the abolition of CAA).
- You will inform me of significant developments relevant to the audit.
- Internal Audit meets the appropriate professional standards.
- Internal Audit undertakes appropriate work on systems that provide material figures in the financial statements sufficient that I can place reliance on it for our audit.
- You provide:
  - good quality working papers and records to support the financial statements before the audit of the financial statements starts;
  - information asked for within agreed timescales; and
  - prompt responses to draft reports.
- There is no allowance for extra work needed to address questions or objections raised by local government electors.

Where these assumptions are not met, I will be required to undertake more work which is likely to result in an increased audit fee.



## Appendix 2 Independence and objectivity

Auditors appointed by the Audit Commission are required to comply with the Commission's Code of Audit Practice and Standing Guidance for Auditors, which defines the terms of the appointment. When auditing the financial statements, auditors are also required to comply with auditing standards and ethical standards issued by the Auditing Practices Board (APB).

I have summarised the main requirements of the Code of Audit Practice, Standing Guidance for Auditors and the standards below.

International Standard on Auditing (UK and Ireland) 260 (Communication of audit matters with those charged with governance) requires the appointed auditor:

- discloses in writing all relationships that may bear on the auditor's objectivity and independence, the related safeguards put in place to protect against these threats and the total amount of fee the auditor has charged the client; and
- confirms in writing the APB's ethical standards are complied with and that, in the auditor's professional judgement, they are independent and their objectivity is not compromised.

The standard defines 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case, the appropriate addressee of communications from the auditor to those charged with governance is the Audit Committee. The auditor reserves the right, however, to communicate directly with the Council on matters which are considered to be of sufficient importance.

The Commission's Code of Audit Practice has an overriding general requirement that appointed auditors carry out their work independently and objectively, and ensure they do not act in any way that might give rise to, or could reasonably be perceived to give rise to, a conflict of interest. In particular, appointed auditors and their staff should avoid entering into any official, professional or personal relationships which may, or could reasonably be perceived to, cause them inappropriately or unjustifiably to limit the scope, extent or rigour of their work or impair the objectivity of their judgement.

The Standing Guidance for Auditors includes some specific rules. The key rules relevant to this audit appointment are as follows.

- Appointed auditors should not perform additional work for an audited body (that is work over and above the minimum required to meet their statutory responsibilities) if it would compromise their independence or might give rise to a reasonable perception that their independence could be compromised. Where the audited body invites the auditor to carry out risk-based work in a particular area that cannot otherwise be

justified as necessary to support the auditor's opinion and conclusions, it should be clearly differentiated within the Audit and Inspection Plan as being 'additional work' and charged for separately from the normal audit fee.

- Auditors should not accept engagements that involve commenting on the performance of other auditors appointed by the Commission on Commission work without first consulting the Commission.
- The District Auditor responsible for the audit should, in all but the most exceptional circumstances, be changed at least once every seven years, with additional safeguards in the last two years.
- The District Auditor and senior members of the audit team are prevented from taking part in political activity on behalf of a political party, or special interest group, whose activities relate directly to the functions of local government or NHS bodies in general, or to a particular local government or NHS body.

The District Auditor and members of the audit team must abide by the Commission's policy on gifts, hospitality and entertainment.

## Appendix 3 Working together

### Meetings

The audit team will ensure we have knowledge of your issues to inform our risk-based audit through regular liaison with key officers.

My proposal for the meetings is as follows.

Table 5: **Proposed meetings with Members and Officers**

Council officers	Audit Commission staff	Timing	Purpose
Chief Executive, Corporate Director (Governance), Head of Finance.	DA and Audit Manager (AM)	Quarterly	General update plus: <ul style="list-style-type: none"> <li>■ April/May - audit plans and VFM Conclusion;</li> <li>■ September - annual governance report; and</li> <li>■ November - annual audit letter.</li> </ul>
Head of Finance	AM and Team Leader (TL)	As required	General update plus: <ul style="list-style-type: none"> <li>■ March - audit plan;</li> <li>■ June - pre-statements;</li> <li>■ July - accounts progress; and</li> <li>■ September - annual governance report.</li> </ul>
Chief Internal Auditor	AM and TL	As required	Update on audit issues.
Audit Committee	DA and AM, with TL as appropriate	Quarterly, as determined by the Committee	Formal reporting of: <ul style="list-style-type: none"> <li>■ Audit Plan;</li> <li>■ Annual governance report; and</li> <li>■ other issues as appropriate.</li> </ul>

### Sustainability

The Audit Commission is committed to promoting sustainability in our working practices and I will actively consider opportunities to reduce our impact on the environment. This will include:

- reducing paper flow by encouraging you to present documentation and working papers electronically;
- use of video and telephone conferencing for meetings as appropriate; and
- reducing travel.

## Appendix 4 Glossary

### **Annual audit letter**

Report issued by the auditor to an audited body that summarises the audit work carried out in the period, auditors' opinions or conclusions (where appropriate) and significant issues arising from auditors' work.

### **Audit of the accounts**

The audit of the accounts of an audited body comprises all work carried out by auditors under the Code to meet their statutory responsibilities under the Audit Commission Act 1998.

### **Audited body**

A body to which the Audit Commission is responsible for appointing the external auditor, comprising both the members of the body and its management (the senior officers of the body). Those charged with governance are the members of the audited body. (See also 'Members' and 'Those charged with governance'.)

### **Auditing Practices Board (APB)**

The body responsible in the UK for issuing auditing standards, ethical standards and other guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

### **Auditing standards**

Pronouncements of the APB, which contain basic principles and essential procedures with which auditors are required to comply, except where otherwise stated in the auditing standard concerned.

### **Auditor(s)**

Auditors appointed by the Audit Commission.

### **Code (the)**

The Code of Audit Practice.

### **Commission (the)**

The Audit Commission for Local Authorities and the National Health Service in England.

## **Ethical Standards**

Pronouncements of the APB that contain basic principles that apply to the conduct of audits and with which auditors are required to comply, except where otherwise stated in the standard concerned.

## **Financial statements**

The annual statement of accounts or accounting statements that audited bodies are required to prepare, which summarise the accounts of the audited body, in accordance with regulations and proper practices for accounts.

## **Internal control**

The whole system of controls, financial and otherwise that is set up to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

## **Materiality (and significance)**

The APB defines this concept as ‘an expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor’s report; similarly a misstatement is material if it would have a similar influence. Materiality may also be considered for any individual primary statement within the financial statements or of individual items included in them. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative aspects’.

The term ‘materiality’ applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, in addition to their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

The concept of ‘significance’ applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit in relation to the financial statements.

Significance has both qualitative and quantitative aspects.

## **Members**

The elected, or appointed, members of local government bodies who are responsible for the overall direction and control of the audited body. (See also ‘Those charged with governance’ and ‘Audited body’.)

## **Remuneration report**

Audited bodies are required to produce, and publish with the financial statements, a remuneration report that discloses the salary and pension entitlements of senior managers.

## **Annual Governance Statement**

Local authorities are required to publish an Annual Governance Statement (AGS) with their financial statements. The AGS is prepared in accordance with guidance issued by CIPFA and disclosures in the AGS are supported and evidenced by the body's assurance framework.

### **Those charged with governance**

Those charged with governance are defined in auditing standards as 'those persons entrusted with the supervision, control and direction of an entity'.

In local authorities, those charged with governance, for the purpose of complying with auditing standards, are the full council, audit committee (where established) or any other committee with delegated responsibility for approval of the financial statements.

Audit committees are not mandatory for local authorities. Authorities are expected to put in place proper arrangements to allow those charged with governance to discuss audit matters with both internal and external auditors. Auditors should satisfy themselves that these matters, and auditors' reports, are considered at the level within the audited body that they consider to be most appropriate.

### **Whole of Government Accounts**

The Whole of Government Accounts initiative is to produce a set of consolidated financial accounts for the entire UK public sector on commercial accounting principles. Local authorities are required to submit a consolidation pack to the department for Communities and Local Government which is based on, but separate from, their statutory accounts.

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The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors, members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.



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