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# Opinion Audit Testing Strategy

Shropshire & Wrekin Fire and Rescue Authority

Audit 2010/11

**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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# Summary

**1** This plan sets out the audit work that I propose to undertake to support my opinion on your 2010/11 financial statements and the value for money conclusion.

**2** My audit of your financial statements is governed by International Standards on Auditing (ISAs). These standards prescribe the basic principles and essential procedures, with the related guidance, which govern my professional conduct as your auditor.

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

**4** 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 clarity.

**5** The new clarified framework applies to my audit of your 2010/11 financial statements. As a result you will see some changes in the way my audit team delivers your audit and the information they seek from you. These changes are highlighted throughout the strategy.

**6** I aim to bring forward as much substantive testing as possible to ease the pressure on the Finance Department and audit team during the post statement testing period. I have met with key finance officers to discuss the approach and agree timings. This is detailed from paragraph 19.

**7** For 2010/11 the Audit Commission requires me to give my statutory VFM conclusion on your arrangements to secure economy, efficiency and effectiveness in relation to two criteria:

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

# 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.**

**8** 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.

### **Responsibilities**

**9** 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.

**10** The Statement summarises where the different responsibilities of auditors and of the audited body begin and end and I undertake my audit work to meet these responsibilities.

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

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

### **Fee for the audit**

**12** The fee for the audit is £63,909 (excl VAT), as indicated in my updated fee letter of 21 February 2011. In setting the fee, I have assumed that:

- the level of risk in relation to 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 Authority 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 as agreed locally.

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 Chief Fire Officer and Treasurer and then prepare a report outlining the reasons why the fee needs to change for discussion with the Audit & Governance Committee.

**13** Further information on the basis for the fee is set out in Appendix 1.

**14** 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 your finance team and Internal Auditors to identify any specific actions that the Authority could take and to provide ongoing 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).

15 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 Authority as at 31 March 2011.

### Identifying opinion audit risks

16 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.

17 As part of my audit risk identification process, I need to fully understand the Authority in order to identify any risk of material misstatement (whether due to fraud or error) in the financial statements. I do this by:

- identifying the business risks facing the Authority, including assessing your own risk management arrangements;
- considering the financial performance of the Authority;
- 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 your information systems.

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

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Table 1: **Specific risks**

Specific opinion risks identified

Risk area	Audit response
<b>Opinion risk</b> There are new requirements for International Financial Reporting for the 2010/11 Statement of Accounts. The 2009/10 financial statements need to be restated using the International Financial Reporting Standards. This is a considerable change and requires additional work for the finance department.	I will review the opening balances, restated under IFRS, as a specific audit procedure prior to the main 2010/11 audit. I will also work with the finance department on any other changes to disclosure for 2010/11 and liaise with relevant finance staff to ensure that key decisions that result in significant changes are discussed in advance. I will bring forward any substantive

Risk area	Audit response
<p><b>Regional Control Centre</b></p> <p>Recent Government announcements mean the Regional Control Centre will not go ahead. Fire &amp; Rescue Authorities are being consulted on the use of the asset going forward and at this time it remains unclear how the relationship needs to be disclosed in the financial statements.</p>	<p>testing I can to ease pressure on your finance department at their busiest time.</p> <p>I will review the Authority's disclosures in relation to the Regional Control Centre and consider the impact of this on potential accounting entries within the financial statements.</p>

## Testing strategy

**19** On the basis of risks identified above I have developed a testing strategy, similar to previous years, which consists of a combination of testing key controls and/or substantive tests of transaction streams and material account balances at year end.

**20** The testing strategy has been developed alongside your finance team and Internal Auditors to maximise the efficiency of the approach. Wherever possible, I will seek to rely on the work of Internal Audit to help meet my responsibilities.

**21** 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 the following area:

- Pension costs, balances and IAS 19 (formerly FRS17) disclosures - reliance on the work of the auditors of the Local Government Pension Scheme Fund Administrators (Shropshire ~~County~~ Council).
- The Audit Commission engages its own expert (PWC) to report on the work of the pension scheme actuaries - I consider this in my audit of the accounting entries relating to the local government pension scheme.

**22** I also plan to rely on the work of experts in the following area:

- Fixed assets valuations - reliance on the work of the valuer (commissioned from Shropshire ~~County~~ Council) who is RICS qualified.
- Valuation trends - reliance on trend information provided by Gerald Eve to the Audit Commission for comparative purposes.
- Pension fund (IAS19) disclosure - reliance on the work of the Pension Fund's actuary (but confirmed by work of another auditor as above).

**23** My testing will be carried out both before and after the draft financial statements have been produced (pre- and post-statement testing). However, one of the changes brought about by the ISA Clarity Project is a greater focus on tests of a substantive nature.

**24** Wherever possible, I will complete some substantive testing earlier in the year before the financial statements are available for audit. Where I identify other possible early testing, I will discuss it with officers.



## ISA clarity

**25** I reported to you in the Statement of Audit Progress the key changes to the International Standards on Auditing (ISAs) and how this will impact on the work I am required to undertake.

## IFRS Restatement

**26** As noted in table 1 above, the 2009/10 financial statements need to be restated using the International Financial Reporting Standards (IFRS).

There will be a number of changes to the 2009/10 statements which will form the opening balances of your 2010/11 financial statements. These include:

- classification of leases,
- inclusion of employee benefits accrual,
- removal of some disclosures, and
- new disclosures such as segmental reporting.

# Value for money conclusion

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

**27** As your appointed auditor I have a continuing statutory responsibility to give a conclusion on whether the Authority has proper arrangements in place for securing economy, efficiency and effectiveness in its use of resources (commonly known as my Value For Money (VFM) conclusion). The work I undertake is directed by the Audit Commission which announced in October 2009 that it would be reviewing its approach to this work to ensure that it was more targeted and gave better value.

**28** The aim is to now focus this work on an auditor's core responsibilities and on local audit issues. For 2010/11 I am required to give my statutory VFM conclusion on your arrangements to secure economy, efficiency and effectiveness in relation to:

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

**29** The VFM conclusion will be in the form of either an unqualified or, if I am not satisfied that the Authority has adequate arrangements in place, qualified VFM conclusion. The key messages from my VFM conclusion work, including suggested areas for improvement, will be reported to the Audit & Governance Committee via the Annual Governance Report and Annual Audit Letter.

**30** I have considered the risks that are appropriate to the current value for money conclusion and have set these out below.

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Table 2: **Specific risks**

Specific VFM risks identified

<b>Risk area</b>	<b>Audit response</b>
<b>Securing Financial Resilience</b>	
<b>Financial Planning</b>	
The Authority is preparing budgets going forward with significant reductions in income.	I will review the medium term financial plans and the 2011/12 budgets to ensure that the Authority has taken appropriate account of their current

Risk area	Audit response
	financial position, the level of income from Central Government and that the plans are supported by detailed and robust assumptions.
<p><b>Savings plan</b></p> <p>The Authority is required to deliver considerable savings to meet their reductions in income over the coming years.</p>	<p>I will review the process for the monitoring and reporting of your savings plans.</p>
<p><b>Securing economy, efficiency and effectiveness</b></p>	
<p><b>Financial resilience</b></p> <p>The recent downturn in the economic environment presents risks for the Authority. The announcement in the Comprehensive Spending Review was marginally less than you had been planning for with pressure falling on the later years as expected. Planning for reductions in the early years is therefore crucial to delivering the savings required which will have an impact on services in the immediate future.</p>	<p>I will review the Authority's position against the savings in its medium term financial plan. I will consider the Authority's response to the economic downturn both in its financial resilience and also in securing economy, efficiency and effectiveness. I will continue to review and discuss the financial position for the year. The year end testing will focus on key estimations around debtor and creditor balances.</p>

## Key milestones and deadlines

**The Authority 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.**

**31** The key stages in producing and auditing the financial statements are in Table 2.

**32** 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.

**33** Every week, 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 3: **Proposed timetable**

Activity	Date
Control and early substantive testing	By April 2011
Receipt of accounts	30 June 2011
Sending audit working papers to the auditor	Mid June 2011 (to be agreed with the Chief Accountant)
Start of detailed testing	Mid June 2011
Progress meetings	Weekly
Present report to those charged with governance at the Audit & Managing Performance Committee	8 September 2011 (tbc)
Issue opinion and value for money conclusion	By 30 September 2011

# The audit team

**The key members of the audit team for 2010/11 are shown in the table below.**

Table 4: **Audit team**

Name	Contact details	Responsibilities
Grant Patterson District Auditor	<a href="mailto:g-patterson@audit-commission.gov.uk">g-patterson@audit-commission.gov.uk</a> 0844 798 7816	Responsible for the overall delivery of the audit including the quality of outputs, signing the opinion and conclusion, and liaison with the Chief Executive.
Emily Mayne Audit Manager	<a href="mailto:e-mayne@audit-commission.gov.uk">e-mayne@audit-commission.gov.uk</a> 0844 798 7173	Manages and coordinates the different elements of the audit work. Key point of contact for the Director of Finance.
Nigel Meredith Team Leader	<a href="mailto:n-meredith@audit-commission.gov.uk">n-meredith@audit-commission.gov.uk</a> 0844 798 4906	Key point of contact for the finance team.

## Independence and objectivity

**34** I am required to disclose to you any relationships that may affect the independence and objectivity of myself as District Auditor or the audit staff. There are no matters I need to bring to your attention.

**35** I comply with the ethical standards issued by the APB and with the Commission's requirements in respect of independence and objectivity as summarised in Appendix 2.

## Meetings

**36** 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

**37** 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.

**38** 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

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

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Table 5: **Planned outputs**

Planned output	Indicative date
Annual governance report	8 September 2011 (tbc)
Auditor's report giving an opinion on the financial statements	30 September 2011
Annual audit letter	November 2011

## Appendix 1 Basis for fee

The Audit Commission is committed to targeting its work where it will have the greatest effect, based upon 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.

The risk assessment process starts with the identification of the significant financial and operational risks applying to the Authority with reference to:

- my cumulative knowledge of the Authority;
  - planning guidance issued by the Audit Commission;
  - the specific results of previous and ongoing audit work;
- interviews with Authority officers; and
- liaison with Internal Audit.

### Assumptions

In setting the fee, I have assumed that:

- the level of risk in relation to the audit of the financial statements is not significantly different from that identified for 2009/10;
- you will inform me of significant developments impacting on the audit;
- Internal Audit meets the appropriate professional standards
- Internal Audit undertakes appropriate work on all systems that provide material figures in the financial statements sufficient that I can place reliance for the purposes of our audit
- you provide:
  - good quality working papers and records to support the financial statements by the date agreed;
  - information asked for within agreed timescales
  - 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 additional 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).

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

International Standard on Auditing (UK and Ireland) 260 (Communication of audit matters with those charged with governance) requires that 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 that the auditor has charged the client; and
- confirms in writing that 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 & Governance Committee. The auditor reserves the right, however, to communicate directly with the Authority 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 that 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 a number of specific rules.

The key rules relevant to this audit appointment are as follows.

- Appointed auditors should not perform additional work for an audited body (i.e. 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 2 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 6: **Proposed meetings with officers**

Fire Authority officers	Audit Commission staff	Timing	Purpose
Chief Fire Officer	District Auditor and Audit Manager	Quarterly	General update including the audit fee in March/April each year.
Treasurer	Audit Manager and Team Leader	Quarterly and in between as required	General update plus: March - audit strategy July - accounts progress September - annual governance report
Chief Accountant	Audit Manager and Team Leader	Quarterly	Update on audit issues
Audit & Managing Performance Committee	District Auditor and Audit Manager	As determined by the Committee	Formal reporting of: Audit Plan Annual Governance Report Other issues as appropriate

### 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 submit documentation and working papers electronically;
- use of video and telephone conferencing for meetings as appropriate; and
- reducing travel.

## Appendix 4 Glossary

### **Annual Audit Letter (AAL)**

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.

### **Annual Governance Statement / Statement on internal control**

Local government bodies are required to publish a statement on internal control (SIC) with their financial statements (or with their accounting statements in the case of small bodies). The disclosures in the SIC are supported and evidenced by the body's assurance framework. At local authorities the SIC is known as the Annual Governance Statement and is prepared in accordance with guidance issued by CIPFA. Police authorities also produce a SIC in accordance with relevant CIPFA guidance. Local probation trusts are required to prepare a SIC in accordance with the requirements specified by HM Treasury in Managing Public Money.

NHS bodies are required to publish a statement on internal control (SIC) with their financial statements. Specific guidance on the preparation of the SIC is issued by the Department of Health. The chief executive, as accountable officer, is required to sign the SIC on behalf of the board. The disclosures in the SIC are supported and evidenced by the body's assurance framework.

### **Audit of the accounts**

The audit of the accounts of an audited body comprises all work carried out by auditors in accordance with 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.

## **Directors**

Members of the board who are collectively and individually responsible for the overall direction and control of the audited body. In NHS bodies there is a unitary board, consisting of executive members and part-time non-executive members, chaired by a non-executive member. The chief executive is responsible to the board for the day-to-day management of the organisation but, as accountable officer, is also responsible to the Department of Health for the proper stewardship of public money and assets. (See also 'Those charged with governance' and 'Audited body').

## **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 in relation to accounts.

## **Internal control**

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

## **International Standards on Auditing (ISAs) UK & Ireland**

Standards issued by the International Audit & Assurance Standards Board governing the work required by External Audit prior to giving their opinion.

## **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; likewise a misstatement is material if it would have a similar influence. Materiality may also be considered in the context of 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 in relation 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’.)

## **Regularity (of expenditure and income)**

Whether, subject to the concept of materiality, the expenditure and income of the audited body have been applied for the purposes intended by parliament, and whether they conform with the authorities that govern them.

## **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.

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

Audit committees are not mandatory for local government bodies, other than police authorities and local probation trusts. Other bodies 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 government bodies, other than probation boards and trusts, 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.