

# **Informing the audit risk assessment East Staffordshire Borough Council 2017/18**



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# Purpose

The purpose of this report is to contribute towards the effective two-way communication between auditors and the Council's Audit Committee, as 'those charged with governance'. The report covers some important areas of the auditor risk assessment where we are required to make inquiries of the Audit Committee under auditing standards.

## Background

Under International Standards on Auditing (UK and Ireland) (ISA(UK&I)) auditors have specific responsibilities to communicate with the Audit Committee. ISA(UK&I) emphasise the importance of two-way communication between the auditor and the Audit Committee and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Audit Committee in understanding matters relating to the audit and developing a constructive working relationship. It also enables the auditor to obtain information relevant to the audit from the Audit Committee and supports the Audit Committee in fulfilling its responsibilities in relation to the financial reporting process.

## Communication

As part of our risk assessment procedures we are required to obtain an understanding of management processes and the Audit Committee's oversight of the following areas:

- fraud
- laws and regulations
- going concern
- related parties
- accounting estimates.

This report includes a series of questions on each of these areas and the response we have received from the Council's management. The Audit Committee should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.

# Fraud

## Matters in relation to fraud

ISA(UK&I)240 covers auditors responsibilities relating to fraud in an audit of financial statements.

The primary responsibility to prevent and detect fraud rests with both the Audit Committee and management. Management, with the oversight of the Audit Committee, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of its oversight, the Audit Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error. We are required to maintain professional scepticism throughout the audit, considering the potential for management override of controls.

As part of our audit risk assessment procedures we are required to consider risks of fraud. This includes considering the arrangements management has put in place with regard to fraud risks including:

- assessment that the financial statements could be materially misstated due to fraud
- process for identifying and responding to risks of fraud, including any identified specific risks
- communication with the Audit Committee regarding its processes for identifying and responding to risks of fraud
- communication to employees regarding business practices and ethical behaviour.

We need to understand how the Audit Committee oversees the above processes. We are also required to make inquiries of both management and the Audit Committee as to their knowledge of any actual, suspected or alleged fraud. These areas have been set out in the fraud risk assessment questions below together with responses from the Council's management.

# Fraud risk assessment

## Question

Has the Council assessed the risk of material misstatement in the financial statements due to fraud?

What are the results of this process?

What processes does the Council have in place to identify and respond to risks of fraud?

Have any specific fraud risks, or areas with a high risk of fraud, been identified and what has been done to mitigate these risks?

Are internal controls, including segregation of duties, in place and operating effectively?

If not, where are the risk areas and what mitigating actions have been taken?

## Management response

Although there is an on-going risk of fraud being committed against the Council arrangements are in place to both prevent and detect fraud. These include work carried out by Internal Audit on overall fraud risk areas, on Council Tax and Housing Benefit fraud.

The risk of material misstatement of the accounts due to undetected fraud is low.

Work is carried out by Internal Audit on overall fraud risk areas and they provide Audit Committee with updates of their work on fraud prevention and detection, including any significant identified frauds and the action taken.

There are no material instances of fraud that have been identified during the year. There are some areas that are inherently at risk from fraud such as:

- Council Tax
- Benefit fraud
- Single person discount
- Social housing tenancy fraud

Whilst benefits fraud investigation has largely been transferred to the DWP, the council has processes in place in order to prevent and detect fraud, including externally commissioned reviews of single person discounts and empty homes reviews as well as participating in the national fraud initiative (NFI).

Yes

Internal Audit include fraud risks in their planning process and act as an effective internal control against fraud.

# Fraud risk assessment (continued)

## Question

Are there any areas where there is a potential for override of controls or inappropriate influence over the financial reporting process (for example because of undue pressure to achieve financial targets)?

Are there any areas where there is a potential for misreporting override of controls or inappropriate influence over the financial reporting process?

How does the Audit Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control?

What arrangements are in place to report fraud issues and risks to the Audit Committee?

How does the Council communicate and encourage ethical behaviour of its staff and contractors?

How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?

Are you aware of any related party relationships or transactions that could give rise to risks of fraud?

Are you aware of any instances of actual, suspected, or alleged fraud either within the Council as a whole or within specific departments since 1 April 2017?

## Management response

Evidence published by the National Fraud Authority amongst others, suggests that fraud is committed in all organisations to varying degrees, so it is likely that some fraud is occurring in the Council. The Internal Audit plan incorporates consideration of potential fraud. In addition to this management is expected to identify and record fraud risks where necessary on the corporate risk register.

No not aware of any areas, but if any were discovered then Internal Audit would assess and report as necessary.

Work is carried out by Internal Audit on overall fraud risk areas and they provide the Audit Committee with updates of their work on fraud prevention and detection, including any significant identified frauds and the action taken.

In addition to this management is expected to identify and record fraud risks where necessary on the corporate risk register.

There is an Anti-Fraud and Corruption Strategy and a Whistleblowing Policy in place which explain the procedures to follow.

Staff are encouraged and expected to report all concerns about suspected fraud.

2016/17 financial statement disclosure of related party transactions did not identify potential fraud risk.

Members and officers are required to make full disclosure of any relationships that impact on their roles. Members are required to declare any relevant interests at Council and Committee meetings.

No

# Laws and regulations

## Matters in relation to laws and regulations

ISA(UK&I)250 requires us to consider the impact of laws and regulations in an audit of the financial statements.

Management, with the oversight of the Audit Committee, is responsible for ensuring that the Council's operations are conducted in accordance with laws and regulations including those that determine amounts in the financial statements.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error, taking into account the appropriate legal and regulatory framework. As part of our risk assessment procedures we are required to make inquiries of management and the Audit Committee as to whether the entity is in compliance with laws and regulations. Where we become aware of information of non-compliance or suspected non-compliance we need to gain an understanding of the noncompliance and the possible effect on the financial statements.

Risk assessment questions have been set out below together with responses from management.

# Impact of laws and regulations

## Question

What arrangements does the Council have in place to prevent and detect non-compliance with laws and regulations?

## Management response

The Monitoring Officer is responsible for ensuring the Council is compliant with laws and regulations. The Constitution notes that these responsibilities cover:

- complying with the law of the land (including any relevant Codes of Conduct);
- complying with any General Guidance issued, from time to time, by the Monitoring Officer;
- making lawful and proportionate decisions; and
- generally, not taking action that would bring the Council, their offices or professions into disrepute.

This officer has access to all Council committee reports. The Monitoring Officer raises awareness on legal requirements at meetings where needed. In addition in terms of any specific legal issues the monitoring officer would get involved at an early stage.

Further information on how the Monitoring Officer carries out these responsibilities are detailed in the Constitution.

How does management gain assurance that all relevant laws and regulations have been complied with?

The Monitoring Officer reports to full Council, where any action taken, or likely to be taken by the Council, its executive members, committee or officers is likely to be contrary to law or result in maladministration.

How is the Audit Committee provided with assurance that all relevant laws and regulations have been complied with?

The S151 officer is responsible for preparing the accounting statements in accordance with relevant legal and regulatory requirements. The Monitoring Officer (or representative) attends the majority of Council meetings and advises members on any areas of concern.

Have there been any instances of non-compliance or suspected non-compliance with law and regulations since 1 April 2017, or earlier with an on-going impact on the 2017/18 financial statements?

No significant instances.



# Impact of laws and regulations (continued)

## Question

## Management response

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What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?

Appropriate legal advice is sought as necessary. In practice the Monitoring Officer is responsible for ensuring that the Council is compliant with laws and regulations and will raise awareness of legal matters / requirements where needed.

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Is there any actual or potential litigation or claims that would affect the financial statements?

There is currently a national case in relation to NHS trusts who are claiming backdated mandatory charitable NNDR Relief.

There is currently a national case in respect of truck cartels.

There is potential for litigation in respect of decision made in regard to planning applications.

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Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate noncompliance?

No

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# Going concern

## Matters in relation to laws and regulations

ISA(UK&I)570 covers auditor responsibilities in the audit of financial statements relating to management's use of the going concern assumption in the financial statements.

Going concern is a fundamental principle in the preparation of financial statements. Under the going concern assumption, a council is viewed as continuing in operation for the foreseeable future with no necessity of liquidation or ceasing trading. Accordingly, the Council's assets and liabilities are recorded on the basis that assets will be realised and liabilities discharged in the normal course of business. A key consideration of going concern is that the Council has the cash resources and reserves to meet its obligations as they fall due in the foreseeable future.

We have discussed the going concern assumption with key Council officers and reviewed the Council's financial and operating performance. Below are key questions on the going concern assumption which we would like the Audit Committee to consider.

# Going concern considerations

## Question

Does the Council have procedures in place to assess the Council's ability to continue as a going concern?

## Management response

The Council continues to face challenges around its medium term financial resilience, but has responded proactively and effectively to the central funding reductions through the development and agreement of its updated Medium Term Financial Strategy (MTFS), in February 2018. The plan extends to 2021/2022.

The approved four year financial strategy covering 2018/19 to 2021/22 is balanced with the use of £0.1m from reserves in 2018/19, rising to £1m in 2019/20. A balanced budget for the period to 2021/22 has been developed, providing assurance on the Council's financial sustainability for the period, together with an approved efficiency plan setting out the approach to identifying future ongoing savings.

The Council has a good record of delivering its savings plans and delivered annual savings over £1m since 2011/12.

Quarterly revenue and capital outturn reports are prepared for Cabinet highlighting variances from the budget or forecasted outturn. The draft outturn at September for 2017/18 indicates a projected under-spend.

Is management aware of the existence of other events or conditions that may cast doubt on the Council's ability to continue as a going concern?

There are no existing events or conditions that cast doubt on the Council's ability to continue as a going concern.

Are arrangements in place to report the going concern assessment to the Audit Committee?

The Chief Finance Officer (as s151 Officer) is satisfied that the budget proposals are based on robust estimates, and that the level of reserves is adequate. This was reported in the Medium Term Financial Strategy.

Are the financial assumptions in that report (e.g., future levels of income and expenditure) consistent with the Council's Business Plan and the financial information provided to the Council throughout the year?

The Financial Plan is agreed at a similar time as the Council Plan. The financial plan makes clear reference to the Council Plan as the basis for the financial considerations in setting the medium term budget. The financial assumptions are therefore consistent with the Council Plan. Reports in year are consistent with the budget set.

# Going concern considerations (continued)

Question	Management response
Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	The financial plan considered explicitly the government changes in terms of grants. The plan sets out the likely implications of the Governments Resources Review and other changes to local government finance.
Have there been any significant issues raised with the Audit Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).	No.
Does a review of available financial information identify any adverse financial indicators including negative cash flow? If so, what action is being taken to improve financial performance?	Individual budget variances are reported to Members on a Quarterly basis and management take action to deal with any adverse variations. Overall, there are no indications of negative financial performance.
Does the Council have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Council's objectives? If not, what action is being taken to obtain those skills?	The Council has adopted a Workforce Planning Strategy in order to mitigate against this risk.

# Related parties

## Matters in relation to Related Parties

Local Authorities are required to comply with International Accounting Standard 24 and disclose transactions with entities/individuals that would be classed as related parties. These may include:

- entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the Council (i.e. subsidiaries);
- associates and/or joint ventures;
- an entity that has an interest in the Council that gives it significant influence over the Council;
- key management personnel, and close members of the family of key management personnel, and
- post-employment benefit plans (pension fund) for the benefit of employees of the Council, or of any entity that is a related party of the Council.

A disclosure is required if a transaction (or series of transactions) is material on either side i.e. if a transaction is immaterial from the Council's perspective but material from a related party viewpoint then the Council must disclose it.

ISA (UK&I) 550 requires us to review your procedures for identifying related party transactions and obtain an understanding of the controls that you have established to identify such transactions. We will also carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate.

Related party considerations have been set out below and management has provided its response.

# Related parties considerations

## Question

What controls does the Council have in place to identify, account for, and disclose related party transactions and relationships?

## Management response

A number of arrangements are in place for identifying the nature of a related party and reported value including:

- Maintenance of a Register of interests for Members, a register for pecuniary interests in contracts for Officers and Senior Managers requiring disclosure of related party transactions.
- Annual return from senior managers and members requiring confirmation that read and understood the declaration requirements and stating details of any known related party interests/transactions.
- Review of in-year income and expenditure transactions with known identified related parties from prior year or known history.
- Review of the accounts payable and receivable systems and identification of amounts paid to/from assisted or voluntary organisation
- Review of year end debtor and creditor positions in relation to the related parties identified.
- Review of minutes of decision making meetings to identify any member declarations and therefore related parties.

Who have the Council identified as related parties?

As well as transactions with central government, pension funds and elected Members, the related parties of the Council include:

- Outside bodies which receive or have received financial support from the Council:
  - East Staffordshire Citizens Advice Bureau
  - East Staffordshire Sports Council
- Outside bodies which have some financial dealings with the Council:
  - Branston Golf and Country Club
  - Burton Albion Community Trust
  - Burton Caribbean Association
  - Staffordshire Wildlife Trust
  - Uttoxeter Heath Community Centre
  - YMCA
  - Trent and Dove Housing

# Accounting estimates

## Matters in relation to Accounting Estimates

Local Authorities need to apply appropriate estimates in the preparation of their financial statements. ISA (UK&I) 540 sets out requirements for auditing accounting estimates. This objective is to gain evidence that the accounting estimates are reasonable and the related disclosures are adequate.

Under this standard we have to identify and assess the risks of material misstatement for accounting estimates by understanding how the Council identified the transactions, events and conditions that may give rise to the need to an accounting estimate.

Accounting estimates are used when it is not possible to measure precisely a figure in the accounts. We need to be aware of all estimates that the Council are using as part of their accounts preparation: these are detailed in appendix 1 to this report.

The audit procedures we conduct on the accounting estimate will demonstrate that:

- the estimate is reasonable; and
- estimates have been calculated consistently with other accounting estimates within the financial statements.

# Appendix 1 - Accounting estimates

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
<p>Property, plant &amp; equipment valuations</p> <p>Revaluation losses on PPE in 2016/17- £93k.</p> <p>Revaluation gains in the reserve - £834k.</p>	<p>Valuations are made by an externally appointed valuer. The valuations are made in line with the Code requirements using RICS guidance on the basis of 5 year valuations with interim reviews</p>	<p>Capital Accountant notifies the valuer of the program of rolling valuations or of any conditions that warrant an interim re-valuation. The valuer undertakes a desk top review of assets not due for full re-valuation.</p>	<p>Use professional valuers – an externally appointed valuer (RICs qualified)</p>	<p>Valuations are made in-line with the Code and RICS guidance - reliance on expert.</p>	<p>No</p>
<p>Estimated remaining useful lives of PPE.</p>	<p>The following asset categories have general asset lives:</p> <ul style="list-style-type: none"> <li>▪ Other Land &amp; Buildings 10 – 100 years</li> <li>▪ Vehicles, Plant and Equipment: <ul style="list-style-type: none"> <li>- Car park ticket machines 15 years.</li> <li>- CCTV Cameras between 5 and 10 years.</li> <li>- Computer Hardware and Software 3 or 5 years</li> </ul> </li> </ul>	<p>Consistent asset lives applied to each asset category.</p>	<p>Use professional valuers – (an externally appointed valuer RICs qualified)</p>	<p>This life would be recorded in accordance with the qualified RICs Members valuation and this would be cross checked to ensure this accords with the accounting policy for the Council.</p>	<p>No</p>



Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
<p>Estimated remaining useful lives of PPE continued.</p>	<p>The following asset categories have general asset lives:</p> <ul style="list-style-type: none"> <li>▪ Vehicles, plant &amp; equipment continued: <ul style="list-style-type: none"> <li>- Parking Meters 15 years</li> <li>- Play Equipment 10 years</li> <li>- Recycling Bins 10 years</li> <li>- Others Between 2 and 10 years</li> </ul> </li> <li>▪ Infrastructure Assets: <ul style="list-style-type: none"> <li>- Bus Shelters 15 years</li> <li>- Lighting 10 years</li> <li>- High Street/New Street improvements 50 years</li> <li>- Tree Planting 100 years</li> <li>- Others, including footpaths, traffic calming, cycle routes etc Between 10 and 25 years</li> </ul> </li> <li>▪ Community Assets: <ul style="list-style-type: none"> <li>- Enhancement of Parks and Open Spaces 10 years.</li> <li>- Works of Art and Sculptures 25 or 50</li> </ul> </li> </ul>	<p>Consistent asset lives applied to each asset category.</p>	<p>Use professional valuers – an externally appointed valuer (RICs qualified)</p>	<p>This life would be recorded in accordance with the qualified RICs Members valuation and this would be cross checked to ensure this accords with the accounting policy for the Council.</p>	<p>No</p>
<p>Depreciation and amortisation</p> <p>Depreciation on non current assets in 2016/17- £1,602k</p> <p>Amortisation on intangible assets in 2016/17 - £15k.</p>	<p>Depreciation is calculated on the following bases:</p> <ul style="list-style-type: none"> <li>▪ Buildings – straight line allocation over the useful life of the property as estimated by the valuer.</li> <li>▪ Vehicles, plant, furniture and equipment – straight line allocation over the useful life of the asset.</li> <li>▪ Infrastructure – straight line allocation over the useful life of the asset.</li> </ul>	<p>Consistent application of depreciation method across all assets.</p>	<p>No</p>	<p>The length of the life is determined at the point of acquisition or revaluation according to:</p> <ul style="list-style-type: none"> <li>■ Assets acquired in the financial year are not depreciated until the following financial year.</li> <li>■ Assets that are not fully constructed are not depreciated until they are brought into use.</li> </ul>	<p>No</p>

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
<p>Impairments</p> <p>Impairment on non current assets in 2016/17 - £nil.</p> <p>Impairment on investments in 2016/17 - £nil.</p>	<p>Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired. Where indications exist and any possible differences are estimated to be material, the recoverable amount of the asset is estimated and, where this is less than the carrying amount of the asset, an impairment loss is recognised for the shortfall</p>	<p>Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired.</p>	<p>Use professional valuers – an externally appointed valuer (RICs qualified) for non current assets.</p>	<p>Valuations are made in-line with the Code and RICS guidance - reliance on expert.</p>	<p>No</p>
<p>Non adjusting events - events after the BS date</p>	<p>Through consultation with Chief Officers, the Chief Accountant makes the assessment. If the event is indicative of conditions that arose after the balance sheet date then this is an un-adjusting event. For these events only a note to the accounts is included, identifying the nature of the event and where possible estimates of the financial effect.</p>	<p>Chief Officers and the monitoring officer notify the Chief Accountant</p>	<p>This would be considered on individual circumstances.</p>	<p>This would be considered on individual circumstances.</p>	<p>N/A</p>
<p>Measurement of Financial Instruments.</p>	<p>Council values financial instruments at fair value based on the advice of their externally appointed treasury consultants and other finance professionals.</p>	<p>Take advice from finance professionals.</p>	<p>Yes</p>	<p>Take advice from finance professionals.</p>	<p>No</p>
<p>Provision for irrecoverable debts</p> <p>£2,044k in 2016/17.</p>	<p>A provision is estimated using a proportion basis of an aged debt listing.</p>	<p>Revenues provide the aged debt listing and Finance calculate the provision.</p>	<p>No</p>	<p>Consistent proportion used across aged debt as per the Code</p>	<p>No</p>

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Accumulated absence account  £195k in 2016/17.	Accrual is based on estimated outstanding leave as at 31 March 2017.	Finance contact a sample of employees directly in order to calculate the estimate	No	Finance assume that the sample is representative of the population.	No
Accruals	Finance, in conjunction with budget managers collate accruals of income and expenditure.  Activity is accounted for in the financial year that it takes place, not when money is paid or received.	Activity is accounted for in the financial year that it takes place, not when money is paid or received.	No	Accruals for income and expenditure have been principally based on known values.  Where accruals have had to be estimated the latest available information has been used.	No
Provisions for liabilities.  £2,187k in 2016/17.	Provisions are made where an event has taken place that gives the Council a legal or constructive obligation that probably requires settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation.  Provisions are charged as an expense to the appropriate service line in the CI&ES in the year that the Council becomes aware of the obligation, and are measured at the best estimate at the balance sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties.	Charged in the year that the Council becomes aware of the obligation.	No	Estimated settlements are reviewed at the end of each financial year – where it becomes less than probable that a transfer of economic benefits will now be required (or a lower settlement than anticipated is made), the provision is reversed and credited back to the relevant service. Where some or all of the payment required to settle a provision is expected to be recovered from another party (e.g. from an insurance claim), this is only recognised as income for the relevant service if it is virtually certain that reimbursement will be received by the Council.	No

