Informing the audit risk assessment for East Staffordshire Borough Council

Year ended 31 March 2019

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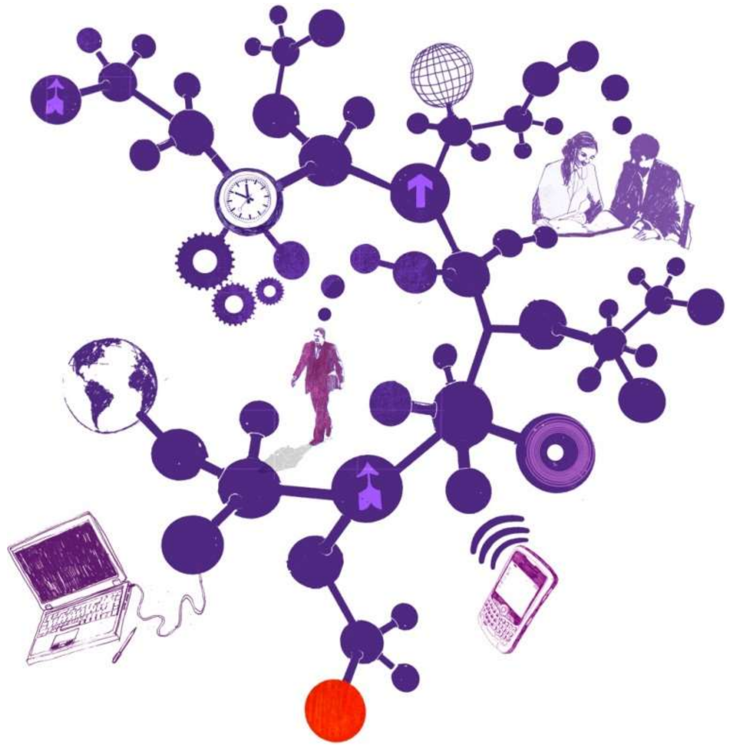

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Purpose

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 party transactions
- Accounting for 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

Issue
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
- follow up and investigations into the NFI data matches and subsequent outcomes

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	Management response
Has the Council assessed the risk of material misstatement in the financial statements due to fraud? What are the results of this process?	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.
What processes does the Council have in place to identify and respond to risks of fraud?	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.

Fraud risk assessment

Question	Management response
Have any specific fraud risks, or areas with a high risk of fraud, been identified and what has been done to mitigate these risks?	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).
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?	Yes Internal Audit include fraud risks in their planning process and act as an effective internal control against fraud.
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)?	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.

Fraud risk assessment

Question	Management response
Are there any areas where there is a potential for misreporting override of controls or inappropriate influence over the financial reporting process?	No not aware of any areas, but if any were discovered then Internal Audit would assess and report as necessary.
How does the Audit Committee exercise oversight over management's processes for identifying and responding to risks of fraud? What arrangements are in place to report fraud issues and risks to the Audit Committee?	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.
How does the Council communicate and encourage ethical behaviour of its staff and contractors?	There is an Anti-Fraud and Corruption Strategy and a Whistleblowing Policy in place which explain the procedures to follow.
How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?	Staff are encouraged and expected to report all concerns about suspected fraud.

Fraud risk assessment

Question	Management response
Are you aware of any related party relationships or transactions that could give rise to risks of fraud?	2017/18 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.
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 2018?	No

Laws and regulations

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

Impact of laws and regulations

Question	Management response
Have there been any instances of non-compliance or suspected non-compliance with law and regulation since 1 April 2018, or earlier with an on-going impact on the 2018/19 financial statements?	No
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.
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 and an ongoing case in respect of ATM rateable values which may be subject to appeal. 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.
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	No

Going concern

Issue
Matters in relation to going concern 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. The going concern assumption is a fundamental principle in the preparation of financial statements. Under this assumption entities are viewed as continuing in business for the foreseeable future. Assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business. The Code of Practice on Local Authority Accounting requires an authority's financial statements to be prepared on a going concern basis. Although the Council is not subject to the same future trading uncertainties as private sector entities, consideration of the key features of the going concern provides an indication of the Council's financial resilience. As auditor, we are responsible for considering the appropriateness of use of the going concern assumption in preparing the financial statements and to consider whether there are material uncertainties about the Council's ability to continue as a going concern that need to be disclosed in the financial statements. We discuss the going concern assumption with management and review the Council's financial and operating performance. Going concern considerations have been set out below and management has provided its response.

Going concern considerations

Question	Management response
Does the Council have procedures in place to assess the Council's ability to continue as a going concern?	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 significant annual savings since 2011/12. Quarterly revenue and capital outturn reports are prepared for Cabinet highlighting forecast variances from the budget. The draft forecast outturn at September for 2018/19 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.

Going concern considerations

Question	Management response
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.
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. The Council has a sound system of internal control which is reflected within the reports presented to Audit Committee.

Going concern considerations

Question	Management response
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

Issue
Matters in relation to Related Parties For local government bodies the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) requires compliance with IAS24: related party disclosures. The Code identifies the following as related parties: • Subsidiaries; • Associates; • Joint ventures • An entity that has an interest in the authority that gives it significant influence; • Key management personnel and close family members; and • Pension fund for the benefit of employees 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 Parties Assessment

Question	Management response
Who are the Councils 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 form 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 - Staffordshire Wildlife Trust - YMCA - Trent and Dove Housing

Related Parties Assessment

Question	Management response
What are the controls in place to identify, account for, and disclose, related party transactions and relationships?	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.

Accounting Estimates

Issue
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. The 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 identifies the transactions, events and conditions that may give rise to the need for 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 is using as part of its accounts preparation; these are detailed in appendix 1 to this report. The audit procedure 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?
Property, plant & equipment valuations Revaluation losses on PPE in 2016/17- £93k. Revaluation gains in the reserve - £834k.	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	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.	Use professional valuers – an externally appointed valuer (RICs qualified)	Valuations are made in-line with the Code and RICS guidance - reliance on expert.	No
Estimated remaining useful lives of PPE.	The following asset categories have general asset lives: ▪ Other Land & Buildings 10 – 100 years ▪ Vehicles, Plant and Equipment: - Car park ticket machines 15 years. - CCTV Cameras between 5 and 10 years. - Computer Hardware and Software 3 or 5 years	Consistent asset lives applied to each asset category.	Use professional valuers – (an externally appointed valuer RICs qualified)	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.	No

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?
Estimated remaining useful lives of PPE continued.	The following asset categories have general asset lives: ▪ Vehicles, plant & equipment continued: - Parking Meters 15 years - Play Equipment 10 years - Recycling Bins 10 years - Others Between 2 and 10 years ▪ Infrastructure Assets: - Bus Shelters 15 years - Lighting 10 years - High Street/New Street improvements 50 years - Tree Planting 100 years - Others, including footpaths, traffic calming, cycle routes etc Between 10 and 25 years ▪ Community Assets: - Enhancement of Parks and Open Spaces 10 years. - Works of Art and Sculptures 25 or 50	Consistent asset lives applied to each asset category.	Use professional valuers – an externally appointed valuer (RICs qualified)	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.	No

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?
Depreciation and amortisation Depreciation on non current assets in 2017/18- £1,540k Amortisation on intangible assets in 2017/18 - £16k.	Depreciation is calculated on the following bases: ▪ Buildings – straight line allocation over the useful life of the property as estimated by the valuer. ▪ Vehicles, plant, furniture and equipment – straight line allocation over the useful life of the asset. ▪ Infrastructure – straight line allocation over the useful life of the asset.	Consistent application of depreciation method across all assets.	No	The length of the life is determined at the point of acquisition or revaluation according to: ■ Assets acquired in the financial year are not depreciated until the following financial year. ■ Assets that are not fully constructed are not depreciated until they are brought into use.	No

Estimates considerations

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?
Impairments Impairment on non current assets in 2017/18 - £nil. Impairment on investments in 2017/18 - £nil.	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	Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired.	Use professional valuers – an externally appointed valuer (RICs qualified) for non current assets.	Valuations are made in-line with the Code and RICS guidance - reliance on expert.	No
Non adjusting events - events after the BS date	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.	Chief Officers and the monitoring officer notify the Chief Accountant	This would be considered on individual circumstances.	This would be considered on individual circumstances.	N/A

Estimates considerations

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?
Measurement of Financial Instruments.	Council values financial instruments at fair value based on the advice of their externally appointed treasury consultants and other finance professionals.	Take advice from finance professionals.	Yes	Take advice from finance professionals.	No
Provision for irrecoverable debts £2,235k in 2017/18.	A provision is estimated using a proportion basis of an aged debt listing.	Revenues provide the aged debt listing and Finance calculate the provision.	No	Consistent proportion used across aged debt as per the Code	No

Estimates considerations

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 2017/18.	Accrual is based on estimated outstanding leave as at 31 March 2018.	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

Estimates considerations

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?
Provisions for liabilities. £2,196k in 2017/18.	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

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