



Grant Thornton

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*Auditing Standards – Communication with the
Finance & Audit Scrutiny Committee*

Warwick District Council

Audit year 2012/2013

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Introduction

The purpose of this report is to ensure there is effective two-way communication between the Council's Finance & Audit Scrutiny Committee, who are 'those charged with governance' and the external auditor.

As your external auditor, we have a responsibility under professional auditing standards to ensure there is effective communication with the Finance & Audit Scrutiny Committee. This means developing a good working relationship with Committee members, while maintaining our independence and objectivity. If this relationship works well it helps us obtain information relevant to our audit and helps Finance & Audit Scrutiny Committee members to fulfil their financial reporting responsibilities. The overall outcome helps to reduce the risk of material misstatement.

In planning and performing our audit of the financial statements we need to understand how the Finance & Audit Scrutiny Committee, supported by the Council's officers, meets its responsibilities in the following areas:

- fraud
- laws and regulations
- going concern
- related party transactions
- accounting for estimates.

This report summarises the respective responsibilities of the Finance & Audit Scrutiny Committee, officers and external audit in each of these areas, as set out by International Standards on Auditing (UK and Ireland) (ISAs). Our primary responsibility is to consider the risk of material misstatement.

Each section of the report includes a series of questions that officers have responded to. We would like to ask the Finance & Audit Scrutiny Committee to consider these responses and confirm that it is satisfied with the arrangements.

Fraud risk assessment

The ISAs define fraud as:

"An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage."

[ISA (UK&I) 240, paragraph 11]

The primary responsibility to prevent and detect fraud is with the Finance & Audit Scrutiny Committee and Council officers. To do this:

- officers need to ensure there is a strong emphasis on fraud prevention and deterrence, with a commitment to honest and ethical behaviour
- Finance & Audit Scrutiny Committee oversight needs to include the potential for the override of controls and inappropriate influence over the financial reporting process.

Our overall responsibility is to ensure the Council's financial statements are free from material misstatement due to either fraud or error. We are required to maintain professional scepticism

throughout the audit, which means considering the potential for the intentional manipulation of the financial statements.

We are also required to carry out a fraud risk assessment to inform our audit approach. This includes considering the following:

- how management assesses the risk of material misstatement in the financial statements due to fraud
- officers' response to assessed fraud risk, including any identified specific risks
- investigations into data matches identified through the National Fraud Initiative and subsequent outcomes
- how officers communicate the processes for assessing and responding to fraud risk to the Finance & Audit Scrutiny Committee
- how officers communicate its views on ethical behaviour to the Finance & Audit Scrutiny Committee
- how the Finance & Audit Scrutiny Committee exercises oversight of officers' fraud risk assessment and response processes and the internal controls to mitigate these risks
- what knowledge the Finance & Audit Scrutiny Committee has of actual, alleged or suspected fraud.

Table 1 below sets out how officers have responded to our fraud risk assessment.

Table 1: Fraud risk assessment

Question	Management response
<p>1. What is officers' assessment of the risk of material misstatement in the financial statements due to fraud? Is this consistent with the feedback from your risk management processes?</p>	<p>The financial statements are subject to internal quality assurance checks which are carried out by the Head of Finance and Strategic Finance Manager.</p> <p>A risk assessment process related to the preparation of accounts takes into consideration the audit issues raised by internal and external audit.</p> <p>The monthly review of Service Revenue and Capital budgets will identify any material risk of material misstatement.</p>
<p>2. Are you aware of any instances of fraud, either within the Council as a whole or within specific departments since 1 April 2012?</p>	<p>The Finance & Audit Scrutiny Committee agenda considers any fraud investigation reports. No instances of significant fraud, has been identified in the year to date.</p>

Question	Management response
<p>3. Do you suspect fraud may be occurring, either within the Council or within specific departments?</p> <ul style="list-style-type: none"> • Have you identified any specific fraud risks? • Do you have any concerns there are areas that are at risk of fraud? • Are there particular locations within the Council where fraud is more likely to occur? 	<p>Investigations of suspected fraud, as a result of cases brought to the attention of the Head of Finance or Audit and Risk Manager, are carried out by the Internal Audit team.</p> <p>No Significant Fraud risk identified.</p> <p>Locations handling income, particularly in the form of cash, are more likely to be at risk of fraud. However, as noted above, these are not significant.</p>
<p>4. Are you satisfied that the overall control environment, including:</p> <ul style="list-style-type: none"> • the process for reviewing the system of internal control; • internal controls, including segregation of duties; • exist and work effectively? <p>If not where are the risk areas? What other controls are in place to help prevent, deter or detect fraud?</p>	<p>Sound systems of internal control with roles and responsibilities are defined in various places such as the Constitution, Code of Financial Practice and Code of Procurement Practice. The Codes are being updated this year and relevant Officers will receive training.</p> <p>The role of Internal Audit, provides assurance that the Council's Internal Controls are in place. Annually, the Audit & Risk Manager provides an opinion on the Council's control environment.</p> <p>Services controls e.g segregation of duties of officers' to mitigate fraud, are in place to support the Council's Anti-Fraud and Corruption Strategy and Whistle Blowing Policy.</p> <p>There is a strong risk management culture, with Finance & Audit Scrutiny Committee actively involved in reviewing Service Risk Registers.</p>
<p>5. How do you communicate to employees about your views on business practices and ethical behaviour? How do you encourage staff to report their concerns about fraud?</p> <ul style="list-style-type: none"> • What concerns are staff expected to report about fraud? 	<p>The updated code of conduct for members and employees outlines the Council's expectations for business practice and ethical behaviour.</p> <p>Employees are aware of the anti-fraud and corruption strategy, details are available on the Intranet.</p> <p>The Monitoring Officer investigates all employee concerns for suspected fraud.</p>

Question	Management response
<p>6. From a fraud and corruption perspective, what are considered to be high-risk posts?</p> <ul style="list-style-type: none"> • How are the risks relating to these posts identified, assessed and managed? 	<p>High risks are preferably linked to activities in the strategic risk registers, and the required level of internal control to manage high risks. These are frequently reviewed. The highest risk financial transactions relate to i) creditor payments; ii) payroll; iii) benefit payments; and iv) council tax/nndr billing and recovery.</p> <p>All four activities will have operational risk assessments and are managed by specific financial instructions to ensure that controls are in place to prevent fraud.</p>
<p>7. Are you aware of any related party relationships or transactions that could give rise to instances of fraud?</p> <ul style="list-style-type: none"> • How do you mitigate the risks associated with fraud related to related party relationships and transactions? 	<p>Most of the related party transactions that could give rise to potential fraud are those in which Councillors have a direct interest. Risks are mitigated, by the Councillor declaration of interest and non-participation in debates.</p> <p>Officers are also expected to declare any potential interest or conflict.</p>
<p>8. What arrangements are in place to report fraud issues to Audit Committee?</p>	<p>The reporting of fraud issues to Finance & Audit Scrutiny Committee is made by various methods ; i) Investigation reports by the Audit and Risk Manager, as a result of the Whistleblowing Policy; ii) Reports by the Head of Finance; and iii) Annual Governance Statement report for Internal Control to mitigate fraud risk.</p>

Laws and regulations

Auditing standards require us to consider the impact that law, regulation and litigation may have on the Council's financial statements. The factors that may result in particular risks of material misstatement due to fraud or error are:

- the operational regulatory framework - this covers the legislation that governs the operations of the Council
- the financial reporting framework - according to the requirements of International Financial Reporting Standards, the Code of Accounting for Local Authorities in England and relevant Directions
- taxation considerations - for example compliance with Value Added Tax and Income Tax regulations
- government policies that otherwise impact on the Council's business
- other external factors
- litigation and claims against the Council.

Where we become aware of information about a possible instance of noncompliance we need to gain an understanding of it to evaluate the possible effect on the financial statements.

The ISAs also require us to make enquiries of management and the Finance & Audit Scrutiny Committee about the arrangements in place to comply with law and regulation. To help with this, management have responded to the following questions.

Table 2: laws and regulations

Question	Management response
1. How does management gain assurance that all relevant laws and regulations have been complied with?	The Monitoring Officer will advise the Council's Corporate Management team and Councillors as appropriate.
2. How is the Audit Committee provided with assurance that all relevant laws and regulations have been complied with?	Assurance of complying with the Council's Constitution is provided through the Annual Governance Statement which is reported to Finance & Audit Scrutiny Committee.
3. Have there been any instances of noncompliance with law and regulation since 1 April 2012?	No
4. Is there any actual or potential litigation or claims that would affect the financial statements?	The Monitoring Officer and Head of Finance actively review and update the contingent liabilities based on their knowledge and information received from Heads of Service. No litigation/claims.

Going concern

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 Finance & Audit Scrutiny Committee to consider.

Table 3 – Going concern

Question	Management response
1. Has a report been received from management forming a view on going concern?	The Executive reports dated 12 December 2012 and 13 February 2013 outlined the 2012/13 forecast outturn and medium term financial plan to 2017/18. No going concern issues.
2. 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 Executive report dated 12 December 2012, outlined the 2012/13 forecast outturn as £627,000 revenue surplus. This is consistent with a balanced revenue budget initially being set for 2012/13.

Question	Management response
<p>3. Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?</p>	<p>The Central Government intention to provide a grant for those authorities who freeze Council tax to taxpayers has been correctly acknowledged in the General Fund Council Tax requirement for 2013/2014.</p> <p>Paragraph 8.8 of the Executive report dated 12 December 2012 states that a grant equivalent to 1% of Council Tax would be available.</p> <p>The Council Tax Base for 2013/14 has been adjusted to reflect the new Council Tax Support Scheme and other Council Tax Reforms being implemented from 1st April 2013.</p> <p>The 2013/14 Budgets and Future Years Projections presented within the 13th February Budget Report allow for the levy retained in respect of the Business Rate Retention Scheme.</p>
<p>4. Have there been any significant issues raised with the Finance & Audit Scrutiny 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).</p>	<p>No</p>
<p>5. Does a review of available financial information identify any adverse financial indicators including negative cash flow or poor or deteriorating performance against the better payment practice code? If so, what action is being taken to improve financial performance?</p>	<p>No</p>
<p>6. 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?</p>	<p>Yes</p>

Accounting estimates

Local authorities need to apply appropriate estimates in the preparation of their financial statements. Accounting estimates are used when it is not possible to measure precisely a figure in the accounts. 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.

We need to be aware of all estimates that the Council are using as part of their accounts preparation; these are detailed at Appendix A.

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

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

Related Parties

For local government bodies, the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) requires compliance with IAS 24: Related party disclosures. The Code identifies the following as related parties to local government bodies:

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

The Code notes that, in considering materiality, regard should be had to the definition of materiality, which requires materiality to be judged from the viewpoint of both the Council and the related party.

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.

Table 4: Related Parties

Question	Management response
1. Who are the Council's related parties?	<p>Central Government bodies e.g Department of Works and Pensions</p> <p>Warwickshire County Council and Warwickshire Police Authority (Crime Commissioner from 2013/14)</p> <p>Warwickshire Parish Councils</p> <p>Waterloo Housing Association</p> <p>Council Members and Chief Officers'</p>

Question

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

Management response

Councillors and Councillors do not participate in decisions where they are a related party.

Annual accounts disclosures for related parties and transactions are reviewed for completeness by the General Fund Accountant.

A 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	Valuations are made by the external and internal valuers (local RICS Members) in line with RICS guidance on the basis of a 5 year rolling programme of valuations for General Fund Fixed Assets and a full revaluation every 5 years for HRA assets with annual desktop reviews in between.	Capital Accountant notifies the valuer of the programme of rolling valuations or of any conditions that warrant an interim re-valuation.	Use the External/ Internal local RICS Member	Valuations are made in-line with RICS guidance - reliance on expert.	No

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	The following asset categories have general asset lives: <ul style="list-style-type: none"> • Buildings 5-90 years • Equipment/vehicles 3-21 years • Plant 3-21 years • Infrastructure 40 years 	Consistent asset lives applied to each asset category.	Use the External/ Internal local RICS Member for valuations.	The method makes some generalisations. For example, buildings, on average, tend to have a useful life of 50 years (council houses 90 years). Although in specific examples based upon a valuation review, a new building can have a life as short as 25 years or as long as 70 years depending on the construction materials used. This life would be recorded in accordance with the external/local qualified RICS Member.	No
Depreciation & Amortisation	Depreciation is provided for on all fixed assets with a finite useful life on a straight-line basis.	Consistent application of depreciation method across all assets.	No	The length of the life is determined at the point of acquisition or revaluation and depreciated on the basis that no depreciation is charged in the year of acquisition. Assets that are not fully constructed are not depreciated until they are brought into use.	No

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	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 the External/ Internal local RICS Member for valuations.	Sample valuations are made in-line with RICS guidance - reliance on expert. The results of these valuations are then extrapolated over similar assets on the basis that any impairment found in the sample would also apply to assets of a similar nature and/or geographical location.	No
Non adjusting events - events after the BS date	S151 Officer makes the assessment. If the event is indicative of conditions that arose after the balance sheet date then this is an unadjusting 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.	Heads of Services notify the S151 Officer.	This would be considered on individual circumstances.	This would be considered on individual circumstances	N/A

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?
Overhead allocation.	The accountants apportion central support costs to services based on appropriate bases.	All support service cost centres are allocated according to the agreed processes.	No	Apportionment bases are reviewed each year to ensure equitable.	No
Measurement of Financial Instruments.	Council values financial instruments at fair value based on the advice of their external treasury consultants and other finance professionals	Take advice from finance professionals.	Yes	Take advice from finance professionals.	No
Bad Debt Provision.	A provision is estimated using a proportion basis of an aged debt listing.	The finance team calculate the provision.	No	Consistent proportion used across aged debt.	No

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.	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

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?
Accruals	Finance collate accruals of Expenditure and Income. 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



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