

# Informing the audit risk assessment for Warwick District Council

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# Purpose

The purpose of this report is to contribute towards the effective two-way communication between the Authority's external auditors and the Authority's Finance and Audit Scrutiny 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 Finance and Audit Scrutiny Committee under auditing standards.

## Background

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

This two-way communication assists both the auditor and the Finance and Audit Scrutiny 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 Finance and Audit Scrutiny Committee and supports them 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 Finance and Audit Scrutiny Committee's oversight of the following areas:

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

This report includes a series of questions on each of these areas and the response we have received from the Authority's management. The Finance and Audit Scrutiny 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 Finance and Audit Scrutiny Committee and management. Management, with the oversight of the Finance and Audit Scrutiny 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 Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As the Authority's external 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 Finance and Audit Scrutiny 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 Finance and Audit Scrutiny Committee oversees the above processes. We are also required to make inquiries of both management and the 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 Authority's management.

# Fraud risk assessment

Question	Management response
<p>Has the Authority assessed the risk of material misstatement in the financial statements due to fraud or error? What are the results of this process?</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>The monthly review of Service Revenue and Capital budgets will identify any material risk of material misstatement.</p>
<p>What processes does the Authority have in place to identify and respond to risks of fraud?</p>	<p>All suspected cases of fraud, theft, corruption should be notified to Head of Finance or the Audit &amp; Risk Manager.</p> <p>Anti Fraud &amp; Corruption and Whistle Blowing Policies in place.</p>
<p>Have any specific fraud risks, or areas with a high risk of fraud, been identified and what has been done to mitigate these risks?</p>	<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>

# Fraud risk assessment continued

Question	Management response
<p>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?</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 updated Code of Procurement Practice was agreed by full Council in April 2017, and the updated Code of Financial Practice in April 2016. The role of internal audit provides assurance that the Council's Internal Controls are in place. Annually, the Audit &amp; 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 &amp; Audit Scrutiny Committee actively involved in reviewing Service Risk Registers.</p>
<p>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) ?</p>	<p>None known.</p>
<p>Are there any areas where there is a potential for misreporting override of controls or inappropriate influence over the financial reporting process ?</p>	<p>None known.</p>
<p>How does the Finance and Audit Scrutiny 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 Finance and Audit Scrutiny Committee?</p>	<p>The reporting of fraud issues to Finance &amp; 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>

# Fraud risk assessment continued

Question	
How does the Authority communicate and encourage ethical behaviour of its staff and contractors?	The updated code of conduct for members and employees outlines the Council's expectations for business practice and ethical behaviour.
How do you encourage staff to report their concerns about fraud? Have any significant issues been reported ?	Employees should be aware of the anti-fraud and corruption strategy and Whistle Blowing Policy, details are available on the Intranet and induction training for all new staff covers fraud and corruption awareness. The Audit & Risk Manager investigates all cases of suspected fraud.
Are you aware of any related party relationships or transactions that could give rise to risks of fraud ?	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 Councillors' declaration of interests and non-participation in debates. Officers are also expected to declare any potential interest or conflict. Senior Managers complete an annual Related Party Declaration. Officers and other individuals involved in tender processes over £50k are required to sign a declaration of interests and will not participate if any potential conflict.
Are you aware of any instances of actual, suspected or alleged fraud, either within the Authority as a whole or within specific departments since 1 April 2017 ?	No.
Are you aware of any whistleblower reports or reports under the Bribery Act since 1 April 2017 ? If so, how has the Finance and Audit and Scrutiny Committee responded to these ?	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 Finance and Audit Scrutiny Committee, is responsible for ensuring that the Authority'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 Finance and Audit Scrutiny 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 Authority have in place to prevent and detect non-compliance with laws and regulations ?	<p>The Council has arrangements in place for legal advice to be provided by Warwickshire County Council.</p> <p>Employees are expected to keep themselves updated of laws and regulations related to their area of work.</p> <p>Suspected non-compliances with laws and regulations will be investigated.</p>
How does management gain assurance that all relevant laws and regulations have been complying with?	<p>Through effective governance processes and review mechanisms such as internal audit.</p> <p>The Monitoring Officer will advise the Council's Corporate Management team and Councillors as appropriate.</p>
How is the Finance and Audit Scrutiny Committee provided with assurance that all relevant laws and regulations have been complied with ?	<p>Service Assurance Statements from each Service Area inform the Annual Governance Statement which is reported to Finance and Audit Scrutiny Committee.</p>
Have there been any instances of non-compliance or suspected non-compliance with laws and regulations since 1 April 2017, or earlier with an on-going impact on the Authority's 2017/18 financial statements ?	<p>No.</p>
What arrangements does the Authority have in place to identify, evaluate and account for litigation or claims ?	<p>All potential insurance claims should be notified by officers to the Council's Insurance and Risk Officer.</p>
Is there any actual or potential litigation or claims that would affect the financial statements ?	<p>There are no material potential claims.</p>

# Impact of laws and regulations (continued)

Question	Management response
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.

Going concern considerations have been set out below and management has provided its response.

# Going concern considerations

Question	Management response
Does the Authority have procedures in place to assess the Authority's ability to continue as a going concern ?	The Council maintains up to date five year financial projections for the General fund and a 50 year HRA Business Plan. These are constantly updated and periodically reported to members and officers. Projections are also held of future level of reserves. Alongside this, potential financial liabilities are monitored. Accordingly, the authority is able to assess any future surplus/deficit and its ability to continue as a going concern.
Is management aware of the existence of other events or conditions that may cast doubt on the Authority's ability to continue as a going concern ?	The financial projections (January 2018), based on current assumptions show the Council needs to find additional savings of circa £500k on its revenue budget so as to be able to maintain existing services . The most recent projections show that savings plans are in place for a significant proportion of this, however these savings still need to be delivered. Also, the Council needs to invest major sums in its corporate assets in future years so as to be able to ensure future service provision.
Are arrangements in place to report the going concern assessment to the Finance and Audit Scrutiny Committee ?	The financial projections and liabilities are reported to the Executive. These reports are scrutinised by the Finance & Audit Scrutiny Committee.
Are the financial assumptions in that report (e.g. future levels of income and expenditure) consistent with the Authority's Business Plan and the financial information provided to the Authority throughout the year ?	Yes, but assumptions will need to change over the year, as the MTFS is a living document. Any changes to assumptions are explained within the reports to Executive.
Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern ?	Yes. All known changes which impact upon the financial projections will be factored in.

# Going concern considerations (continued)

Question	Management response
<p>Have there been any significant issues raised with the Finance and Audit Scrutiny Committee during the year which could cast doubts on the assumptions made ? (Examples include adverse comments raised by Internal Audit regarding financial performance or significant weaknesses in systems of financial control).</p>	<p>No. Recent favourable Internal Audit report on the Financial Planning gave Substantial Assurance.</p>
<p>Does a review of available financial information identify any adverse financial indicators including negative cash flow ? If so, what action is being taken in improve financial performance ?</p>	<p>No. See earlier comments on projected long term shortfall.</p>
<p>Does the Authority have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Authority's objectives ? If not, what action is being taken to obtain those skills ?</p>	<p>Sufficient staff in post with the appropriate skills and experience.</p>

# Related Parties

## Issue

### Matters in relation to Related Parties

Local Authorities are required to comply with IAS 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 authority (i.e. subsidiaries);
- associates;
- joint ventures;
- an entity that has an interest in the authority that gives it significant influence over the authority;
- 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 authority, or of any entity that is a related party of the authority.

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 Authority perspective but material from a related party viewpoint then the Authority 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.

Question	Management response
<p>What controls does the Authority have in place to identify, account for and disclose related party transactions and relationships ?</p>	<p>Officers 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. Officers and other individuals involved in tender processes over £50k are required to sign declaration of interests and will not participate if any potential conflict.</p>

# Accounting estimates

## Issue

### Matters in relation to accounting estimates

Local Authorities 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 Authority 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 Authority is using as part of its 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.

We would ask the Finance and Audit Scrutiny Committee to satisfy itself that the arrangements for accounting estimates are adequate.

## Question

Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable ?

## Management response

Yes. Where estimation is necessary, appropriate estimating methodology is utilised. Estimates will be prepared by those best qualified, e.g. Pension Fund Actuary to supply estimates relating to IAS 19 – Employee Benefits, assets are professionally valued.

# Accounting estimates cont..

Question	Management response
How is the Finance and Audit Scrutiny Committee provided with assurance that the arrangements for accounting estimates are adequate ?	Details of estimates disclosed in accounting policies within Accounts. Finance & Audit Scrutiny Committee consider this document prior to sign off by the Head of Finance.



# Appendix 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 Valuations	Property valuations are made by the external valuer from Carter Jonas. Significant Heritage Assets valued by external valuer. Minor valuations provided by Art Gallery & Museum staff.	Valuer notified of changes to the estate from the prior year	Use the external valuer (RICS qualified) from Carter Jonas for PPE. Significant Heritage Assets valued by external valuer. Minor valuations provided by Art Gallery & Museum staff.	Valuations are made in-line with the CIPFA Code of Practice guidance - reliance on expert	No
Estimated remaining useful Lives of PPE	Assets are assigned to asset categories with appropriate asset lives.	Consistent asset lives applied to each asset category.	Use the external valuer (RICS qualified) from Carter Jonas	The useful lives of property are recorded in accordance with the recommendations of the external RICS qualified valuer.	No
Depreciation	Depreciation is provided for on property plant and equipment with a finite useful life on a straight-line basis	Consistent application of depreciation method across assets	No	The length of the life is determined at the point of acquisition or revaluation.	No

# Appendix A Accounting Estimates (Continued)

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 valuer (RICS qualified) from Carter Jonas. Reliance on Art Gallery & Museum staff to assess whether or not a Heritage Asset needs to be impaired. If necessary, revised valuation will be provided by suitably qualified person.	Valuations are made in-line with the CIPFA Code of Practice guidance - reliance on expert	No
Provision for doubtful debts	A provision is estimated using a proportion basis of an aged debt listing.	The finance team calculate the provision.	No	Consistent proportion used across debt.	No

# Appendix A Accounting Estimates (Continued)

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	Measurements are obtained from appropriate sources. The Authority follows the requirements of the CIPFA Code of Practice.	The financial instruments are measured by the Treasury Accountant and the accounts are reviewed by the Strategic Finance Manager .	No	The measurements are based upon the best information held at the current time and are provided by experts in their field.	No
Creditor accruals	Accruals are estimated by reviewing goods and services received prior to the end of the financial year for which an invoice has not been received.	The date of receipt of the goods and services is used in the estimation of the accrual.	No	The use of actual dates of receipt of goods and services gives a low degree of uncertainty.	No

# Appendix A Accounting Estimates (Continued)

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?
Pension Fund Actuarial gains/losses	The actuarial gains and losses figures are calculated by the actuarial experts(Hymans Robertson) These figures are based on making % adjustments to the closing values of assets/liabilities.	For the LGPS the Authority responds to queries raised by the administering authority Warwickshire County Council.	The Authority are provided with an actuarial report by Hymans Robertson (LGPS) .	The nature of these figures forecasting into the future are based upon the best information held at the current time and are developed by experts in their field.	No
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	Appropriate bases are reviewed each year to ensure equitable.	No

