



Grant Thornton

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Auditing Standards – Communication with the Audit Board and Cabinet

Bromsgrove 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 'Those Charged with Governance' and the Engagement Lead, the Council's external auditor. In most Councils the Audit Committee undertakes the role of 'Those Charged with Governance' and thus our communication is with the Audit Committee.

In Bromsgrove the Cabinet retain the role of 'Those Charged with Governance' and the Audit Board receives reports on internal control and fraud. The Audit Board provides assurance on the operation of internal controls to Cabinet.

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

In planning and performing our audit of the financial statements we need to understand how Cabinet, supported by the Council's management, and the Audit Board meets its responsibilities in the following areas.

- Fraud
- Law and regulation
- Going concern
- Related parties
- Accounting for estimates

This report summarises the Cabinet's, Audit Board, management's and the external auditor's responsibilities in each of these areas, as explained in the 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 management have responded to. We would like to ask the Audit Board and the Cabinet 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 Audit Committee and the Council's management. To do this:

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

As your auditors 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.
- How officers communicate its process for assessing and responding to fraud risk to the Audit Board and Cabinet
- How management communicates its views on ethical behaviour to the Audit Board and Cabinet
- How the Audit Board and Cabinet exercise oversight of management's fraud risk assessment and response processes and the internal controls to mitigate these risks.
- What knowledge the Audit Board and Cabinet has of actual, alleged or suspected fraud.

To help us in making our fraud risk assessment management have responded to the following questions.

Table 1: Fraud Risk Assessment

Question	Management response
<p>1. What is management’s assessment of the risk of material misstatement in the financial statements due to fraud?</p> <p>Is this consistent with the feedback from your risk management processes?</p>	<p>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 and work on Council Tax and Housing Benefit fraud.</p> <p>There is on-going communication between external audit and responsible officers on emerging technical issues. Officers also attend technical updates.</p> <p>Financial monitoring reports also highlight areas of variance within the capital and revenue budgets and this assists management in identifying areas of material misstatement within the accounts.</p> <p>The Council is currently reviewing and updating its risk management processes and procedures.</p> <p>Management considers there is a low risk of material misstatement in the financial statements due to fraud.</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>There are some areas that are inherently at risk from fraud such as:</p> <ul style="list-style-type: none"> ■ Council Tax ■ Benefit fraud ■ Single person discount <p>However, there is a dedicated benefits investigation team which investigates any fraud.</p> <p>The Audit Board receives any adhoc fraud reports.</p> <p>There are no material instances of fraud that have been identified during the year.</p>

<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>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 Authority.</p> <p>Locations handling income, particularly in the form of cash, are more likely to be at risk of fraud. However management does not consider these to be significant risks.</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? – If not where are the risk areas? – What other controls are in place to help prevent, deter or detect fraud? 	<p>Yes - Internal Audit include fraud risks in their planning process and act as an effective internal control against fraud.</p> <p>Sound systems of internal control with roles and responsibilities are defined in various places such as the Constitution.</p> <p>The role of internal audit, provides assurance that the Council's internal controls are in place. An annual report is produced and is available prior to the annual accounts being signed and approved.</p>

<p>5. How do you communicate to employees about your views on business practices and ethical behaviour?</p> <p>How do you encourage staff to report their concerns about fraud?</p> <p>– What concerns are staff expected to report about fraud?</p>	<p>There is a Fraud Strategy and a Whistleblowing procedure in place which explain the procedures to follow.</p> <p>Employees are aware of the anti-fraud of the anti-fraud and corruption strategy, details are available on the website.</p>
<p>6. From a fraud and corruption perspective, what are considered to be high-risk posts?</p> <p>– How are the risks relating to these posts identified, assessed and managed?</p>	<p>There are not any significantly high-risk posts identified.</p>
<p>7. Are you aware of any related party relationships or transactions that could give rise to instances of fraud?</p> <p>– How do you mitigate the risks associated with fraud related to related party relationships and transactions?</p>	<p>2011/12 financial statement disclosure of related party transactions does not identify potential fraud risk.</p> <p>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.</p>
<p>8. What arrangements are in place to report fraud issues to Audit Board?</p>	<p>Internal Audit provide the Audit Board with updates of their work on fraud prevention and detection, including any significant identified frauds and the action taken.</p> <p>Any adhoc investigations are reported to the Audit Board</p>

Law and Regulation

The ISAs (ISA (UK&I) 250) require us to consider the impact that law and 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; and
- 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 TCWG about the arrangements in place to comply with law and regulation. To help with this, management have responded to the following questions.

Table 2: Law and Regulation

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 Management team and Councillors as appropriate.
2. How is the Audit Board and Cabinet 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 Cabinet.

<p>3. Have there been any instances of noncompliance with law and regulation since 1 April 2012?</p>	<p>No.</p>
<p>4. Is there any actual or potential litigation or claims that would affect the financial statements?</p>	<p>None.</p>

Going Concern

Going concern is a key concept in the preparation of the financial statements for the Council. The accounting concept of going concern refers to the basis of measurement of an organisation's assets and liabilities in its accounts (that is, the basis on which those assets and liabilities are recorded and included in the accounts).

The going concern assumption is a fundamental principle in the preparation of financial statements. 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. If the entity could not continue as a going concern, assets and liabilities would need to be recorded in the accounts on a different basis, reflecting their value on the winding up of the entity. Consequently, assets would be likely to be recorded at a much lower break-up value and medium- and long-term liabilities would become short term liabilities.

The Council is not subject to the same future trading uncertainties as private sector entities. However, consideration of the key features of the going concern provides an indication of the Council's financial resilience. It may indicate that some classes of assets or liabilities should not be valued on an on-going basis.

We discuss the going concern assumption with key Council officers and review the Council's financial and operating performance. Below are key questions on the going concern assumption which we would like the Cabinet to consider.

Table 3 – Going concern

<p>Question</p>	<p>Management response</p>
<p>1. Has a report been received from management forming a view on going concern?</p>	<p>The Director of Finance and Corporate Resources (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.</p>

<p>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?</p>	<p><i>The Financial Plan is agreed at the same 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.</i></p>
<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 financial plan considered 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, such as the new Council Tax Support scheme and other Council tax reforms being implemented from 1st April 2013 in addition to the Business rates retention scheme.</p>
<p>4. Have there been any significant issues raised with the Audit Board 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?</p> <p>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?</p> <p>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. 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 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.

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 authority (i.e. subsidiaries);
- associates;
- joint ventures in which the authority is a venturer;
- 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 plan (pension fund) for the benefit of employees of the authority, or of any entity that is a related party of the authority.

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 authority 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
<p>1. Who are the Council's related parties?</p>	<p>The Council discloses its related parties under the following headings:</p> <ul style="list-style-type: none">(1) Government - central government has control influence over the Council as the Council needs to act in accordance with its statutory responsibilities.(2) Pension Fund - this party is subject to common control by central government.(3) Precepts & Levies - these parties are subject to common control by central government and thus might be empowered to transact on non-commercial terms. The Council is bound to pay the amount demanded from these parties through precept or levy.4) Group relationship with Atrix.(5) Assisted Organisations - the provision of financial assistance by the Council to such parties or voluntary organisations may give the Council influence on how the funds are to be administered and applied.(6) Members and Officers - Certain Members and Officers may have controlling influence or related interests with other of the Council's related party organisations, such that they may be in a position to significantly influence the policies of the Council.

<p>2. What are the controls in place to identify, account for, and disclose, related party transactions and relationships?</p>	<p>A number of arrangements are in place for identifying the nature of a related party and reported value including:</p> <ul style="list-style-type: none"> ■ 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/officers requiring confirmation that read and understood the declaration requirements and stating details of any known related party interests. ■ 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.
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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.	The Council has a contract with Worcestershire County Council property department to manage its asset base, including undertaking annual valuations. The Valuer is a RICS/CIB Member) and reviews are made inline with 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.	Yes, the Worcestershire County Council valuer	Valuations are made in-line with RICS guidance - reliance on an expert.	No.
Estimated remaining useful lives of PPE.	The following asset categories have general asset lives: <ul style="list-style-type: none"> ■ Buildings 50 years ■ Equipment/vehicles 5 years ■ Plant 12 years ■ Infrastructure 40 years. 	Consistent asset lives applied to each asset category.	Yes, the Worcestershire County Council valuer	The method makes some generalisations. For example, buildings tend to have a useful life of 50 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 local qualified RICS or CIB Member.	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?
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 according to: <ul style="list-style-type: none"> ■ Assets are not depreciated in the year of acquisition; a full year's depreciation is charged in the year of disposal ■ Assets that are not fully constructed are not depreciated until they are brought into use. 	No.
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.	Worcestershire County Council Valuer.; plus all the heads of service are asked to review a list of assets and confirm they are still in use, life appropriate etc.	Valuations are made in-line with RICS guidance - reliance on one 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?

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
Overhead allocation.	The Cost Centre Management Team apportion central support costs to services based on fixed bases as detailed in the 'Allocation Summary' spread sheet.	All support service cost centres are allocated according to the agreed 'Allocation Summary' spread sheet.	No	Apportionment bases are reviewed regularly to ensure equitable	No
Measurement of Financial Instruments.	Council values financial instruments at fair value based on the advice of their internal treasury consultants and other finance professionals.	Take advice from finance professionals.	Yes	Take advice from finance professionals.	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?
Bad Debt	A provision is estimated using	An aged debt listing is	No	Consistent proportion	No

Provision.	a proportion basis of an aged debt/listing.	provided routinely and finance calculate the provision.		used across aged debt as per the SORP.	
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	CCMT collate accruals of Expenditure and Income. Activity is accounted for in the financial	Activity is accounted for in the financial year that it takes place (in line with thresholds identified	No	Accruals for income and expenditure have been principally based on known values. Where	No

	year that it takes place, not when money is paid or received.	in the accounting policies) , not when money is paid or received.		accruals have had to be estimated the latest available information has been used.	
Landfill Allowance liability.	As landfill is used, a liability and an expense are recognised. The liability is discharged either by surrendering allowances or by payment of a cash/ penalty to DEFRA (or by a combination).	Finance check calculations from DEFRA.	No	The liability is measured at the best estimate of the expenditure required to meet the obligation, normally the market price of the number of allowances required to meet the liability at the reporting date. However, where some of the obligation will be met by paying a cash penalty to DEFRA, that part of its liability is measured at the cost of the penalty.	No