

# Informing the audit risk assessment for Herefordshire Council

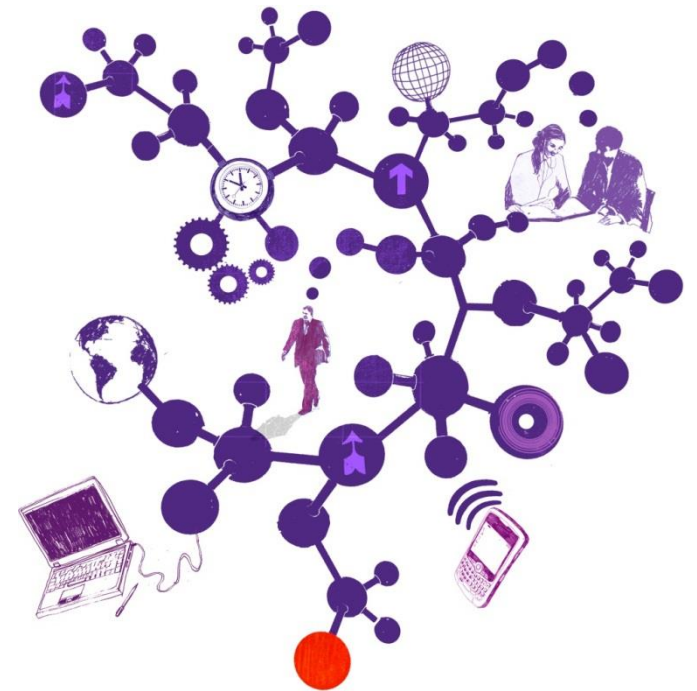
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**Phil Jones**  
Director  
T 0121 232 5232  
E [phil.w.jones@uk.gt.com](mailto:phil.w.jones@uk.gt.com)

**Terry Tobin**  
Audit Manager  
T 0121 232 5276  
E [terry.p.tobin@uk.gt.com](mailto:terry.p.tobin@uk.gt.com)

**Sarah Good**  
Executive  
T 0121 2325334  
E [sarah.l.good@uk.gt.com](mailto:sarah.l.good@uk.gt.com)



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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.

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.

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
<p>Has the Council assessed the risk of material misstatement in the financial statements due to fraud? What are the results of this process?</p>	<p><i>The risk of material misstatement of the accounts due to undetected fraud is low. Although there is an ongoing risk of fraud being committed against the council, clear and effective arrangements are in place to both prevent and detect fraud.</i></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><i>There have been no specific or high risk areas of fraud identified since April 2014. Herefordshire Council returned the annual Audit Commission Survey</i></p>
<p>Do you suspect fraud may be occurring, either within the council or within specific departments?</p> <ul style="list-style-type: none"> <li>- Have you identified any specific fraud risks?</li> <li>- Do you have any concerns there are areas that are at risk of fraud?</li> <li>- Are there particular locations within the Council where fraud is more likely to occur?</li> </ul>	<p><i>We do not suspect fraud is occurring within the Council. However, evidence published by the National Fraud authority amongst others, suggests that fraud is committed in all organisations to varying degrees, so it is possible that some fraud is occurring at Hereford. In order to mitigate fraud occurring the Council has a number of processes in place.</i></p> <p><i>The internal audit plan incorporates consideration of potential fraud risks and how these are to be mitigated, for example through the reviews of the Council's key systems and the work it completes on the Councils Anti-Fraud processes to ensure that they are fit for purpose.</i></p> <p><i>In addition to this management is expected to identify and record fraud risks where necessary on the corporate risk register. There are some areas that are inherently at risk such as:</i></p> <ul style="list-style-type: none"> <li>- <i>Council tax; and</i></li> <li>- <i>Housing benefit</i></li> </ul> <p><i>However, there is a dedicated benefits team within the Corporate Finance division which investigates any potential fraud issues.</i></p>

# Fraud risk assessment

Question	Management response
<p>Are you satisfied that the overall control environment, including:</p> <ul style="list-style-type: none"> <li>- The process for reviewing the system of internal control;</li> <li>- Internal controls, including segregation duties;</li> <li>- Exist and work effectively</li> </ul> <p>If not where are the risk areas?            What other controls are in place to help prevent, deter or detect fraud?</p>	<p>Yes</p> <p><i>In the Annual Assurance Statement issued in July 2014 for the internal audits carried out in the previous year the Head of Internal Audit concluded: We have not identified any significant findings for the key control audits, however we have identified some issues with segregation of duties at Schools and generally inadequate control framework. So yes there is a risk of fraud however our work did not identify any fraudulent activity. All schools have been responsive to the findings and have agreed action plans to address the weaknesses.</i></p> <p><i>The problems seem to stem from lack of guidance and understanding leading to poor practice rather than any intention to commit fraud.</i></p>
<p>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?            What concerns are staff expected to report about fraud?</p>	<p><i>The Council has an Anti-Fraud Strategy and a Whistleblowing procedure in place which explains the procedures to follow when staff need to raise any fraud concerns. These policies and procedures are available to all staff via the Council's intranet.</i></p>
<p>From a fraud and corruption perspective, what are considered to be high-risk posts?            - How are the risks relating to these posts identified, assessed and managed?</p>	<p><i>There are not any significantly high- risk posts identified</i></p>

# Fraud risk assessment

Question	Management response
<p>Are you aware of any related party relationships or transactions that could give rise to risks of fraud?</p> <p>- How do you mitigate the risks associated with fraud related to related party relationships and transactions</p>	<p><i>We are not aware of any related party in 2014-15 which would give rise to a risk of fraud</i></p> <p><i>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</i></p>
<p>What arrangements are in place to report fraud issues to Audit Committee?</p>	<p><i>Internal Audit provided the Audit and Governance Committee with updates of their work on fraud prevention and detection, including any significant identified frauds and the action taken.</i></p>



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# 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
<p>How does management gain assurance that all relevant laws and regulations have been complied with?</p>	<p><i>The role of the Monitoring Officer is defined in the Constitution as 'responsible for reporting the actual or potential breach of a legal requirement to the Council meeting or Cabinet'.</i></p> <p><i>The monitoring Officer is supported by a team of Legal and Democratic Services Officers and the Resilience Team. Together they advise him of any matters of concern.</i></p> <p><i>The Monitoring Officer sees all reports to the Officer Leadership Team and all reports to Members.</i></p> <p><i>All reports to Members are required to have a legal implications section and a risk section.</i></p> <p><i>The Section 151 officer is responsible for preparing the accounting statement in accordance with relevant legal and regulatory requirements.</i></p>
<p>How is the Audit Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p><i>The Monitoring Officer (or representative) attends Audit and Governance Committee Meetings when legal issues arise and advises members on any areas of concern.</i></p>

# Impact of laws and regulations

Question	Management response
<p>Have there been any instances of non-compliance or suspected non-compliance with law and regulation since 1 April 2014, or earlier with an on-going impact on the 2014/15 financial statements?</p>	<p><i>The following audits carried out since the 1st April 2014 were assessed as 'Partial' assurance – Procurement and four schools. One further school was assessed as 'No' assurance.</i></p> <p><i>Follow up audits have been completed on four audits - Legal Services, Income Collection, Gypsy and Traveller service, and Data Protection. These audits were assessed as 'Limited' assurance by the previous audit provider, one further audit assessed as 'Limited' Health &amp; Safety is currently in progress. Follow up work reviews the progress against agreed actions.</i></p> <p><i>In all cases steady progress has been made to address the issues. However I would note that the Gypsy and Traveller service still had a number of actions outstanding – all actions have been reviewed as part of the follow up and a new implementation date agreed.</i></p>
<p>Is there any actual or potential litigation or claims that would affect the financial statements?</p>	<p><i>There is an ongoing case involving a claim from a care home . There is also a on-going dispute with a previous service provider around amounts due to and from them at the close of the contract.</i></p> <p><i>Legal proceedings have been commenced against the Council (and other Councils) by private search companies in relation to Land charges.</i></p>

# 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
Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	<i>The financial plan considered the government changes in terms of grant settlement and the financial settlement. The plan is updated to reflect the financial settlement</i>
Have there been any significant issues raised with the Audit Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control)	No
Does a review of available financial information identify any adverse financial indicators including negative cash flow or poor or deteriorating performance against the better payment practice code? If so, what action is being taken to improve financial performance?	No
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	Yes

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# Accounting Estimates

## Issue

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.

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.

# Accounting Estimates

Estimate	Method/model used to make estimate	Controls used to identify estimates	Whether management have used an expert	Underlying assumptions; -Assessment of degree of uncertainty -consideration of alternative estimate	Has there been a change in accounting estimates in the year?
Property Plant and Equipment Estimate	Valuations will be made by an external valuer in line with RICS guidance on the basis of 5 year valuations with interim reviews. The only valuations carried out by Property Services internally are Smallholdings, the review of property valuations < £5k and they will also do the impairment review at the year end as their local knowledge is needed.	There is a rolling program of valuations and the finance team issues terms of engagement covering specific issues for the year	The external and internal valuers are members of RICS.	Valuations are made in line with RICS guidance-reliance on expert	No
Measurement of financial instruments	Council values financial instruments at fair value based on the advice of their external treasury consultants	Take advice from professionals	Yes	Take advice from treasury management professionals	No
Overhead allocation	The finance team apportion central support costs to services based on fixed bases	All support service cost centres are allocated according to the most appropriate allocation basis for each activity	No	Apportionment bases are reviewed each year to ensure they are equitable	No

# Accounting Estimates

Estimate	Method/model used to make estimate	Controls used to identify estimates	Whether management have used an expert	Underlying assumptions; -Assessment of degree of uncertainty -consideration of alternative estimate	Has there been a change in accounting estimates in the year?
Provisions for liability	Provisions are made where an event has taken place that gives the Council 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, taking into account relevant risks and uncertainties	Charged in the year that the council becomes aware of the obligation	The level of insurance provision was reviewed in 2014/15 by the councils insurance broker	Estimated settlements are reviewed at the end of each financial year. The insurance provision is periodically reviewed by the council's insurance broker	No
Accruals	Activity is accounted for in the financial year that it takes place, not when money is paid or received	Procedures for identifying accruals are included in the closedown instructions	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



# Accounting Estimates

Estimate	Method/model used to make estimate	Controls used to identify estimates	Whether management have used an expert	Underlying assumptions; -Assessment of degree of uncertainty -consideration of alternative estimate	Has there been a change in accounting estimates in the year?
PFI	<p>PFI and similar schemes contracts are agreements to receive services, where the responsibility for making available or improving the asset to provide the services passes to the PFI contractor. As the Council is deemed to control the services that are provided under its PFI schemes, it carries the assets used under the contracts on its balance sheet as part of the property, plant and equipment.</p> <p>The original recognition of these assets at fair value (based on the cost to purchase the property, plant and equipment) is balanced by the recognition of a liability for amounts due to the scheme operator to pay for the capital investment</p>	<p>The models for the PFI contracts are used to produce the accounts. Assets are valued in line with other PPE assets.</p>	<p>Use of model for calculating PFI payment elements</p>	<p>Valuations are made in line with RICS guidance-reliance on experts</p>	No
Defined benefit pension amounts and disclosures	<p>Non-teaching staff are members of the Local Government Pensions Scheme, administered by Worcestershire County Council</p>	<p>Rely on the calculations made by the actuary</p>	<p>The actuary of the pensions scheme</p>	<p>Reliance on the expertise of the actuaries of the pension scheme</p>	No

# Related Parties

## Issue

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 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 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 Consideration

Question	Management response
Who are the Council's related parties?	<p><i>The Council has a number of related parties in which there is a material impact to the financial statements via virtue of- whether the Council might have the potential either to be controlled or influenced by the party or the potential to exert control or influence over the party.</i></p> <p><i>The Council discloses its related parties under the following headings:</i></p> <ol style="list-style-type: none"> <li><i>1) Central Government</i></li> <li><i>2) Members</i></li> <li><i>3) Officers</i></li> <li><i>4) Other public bodies (Including Worcestershire County Council, Wye Valley Trust, 2Gether and the Clinical Commissioning Group)</i></li> <li><i>5) Significant long-term contracts (Including Amey Wye Valley, Balfour Beatty FOSCA UK)</i></li> <li><i>6) Other organisations (including Hoople, HALO Leisure Trust, Herefordshire Housing Ltd, Hereford Futures and West Mercia Energy)</i></li> </ol>
What are the controls in place to identify, account for, and disclose, related party transactions and relationships?	<p><i>A number of arrangements are in place for identifying the nature of a related party and reported value including:</i></p> <ul style="list-style-type: none"> <li><i>- Maintenance of a Register of Interests for Members</i></li> <li><i>- Annual return from senior managers/officers</i></li> <li><i>- Review of in-year income and expenditure transactions with known identified related parties from prior year or known history</i></li> </ul> <p><i>Review of year end debtors and creditors analysing systems and manual accruals records.</i></p>



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