

Informing the audit risk assessment

Year ending 31 March 2018

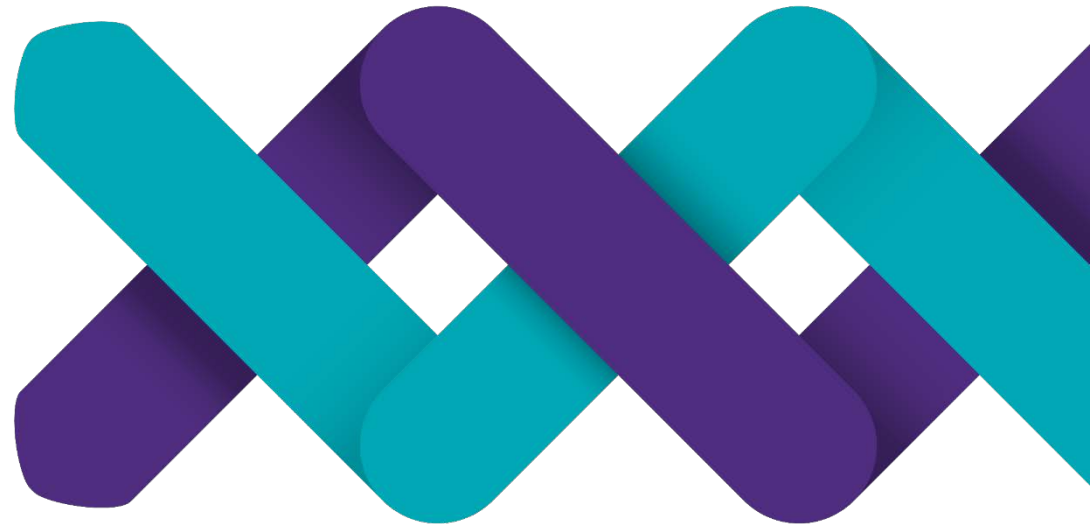
Herefordshire Council

March 2018

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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 & Governance 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 & Governance 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 & Governance Committee. ISA(UK&I) emphasise the importance of two-way communication between the auditor and the Audit & Governance Committee and also specify matters that should be communicated.

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

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

This report includes a series of questions on each of these areas and the response we have received from the Council's management. The Audit & Governance Committee should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.

Fraud

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 & Governance Committee and management. Management, with the oversight of the Audit & Governance 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 & Governance 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 & Governance 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 & Governance Committee oversees the above processes. We are also required to make inquiries of both management and the Audit & Governance 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>The risk of material misstatement of the accounts due to undetected fraud is considered to be 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.</p>
<p>What processes does the Council have in place to identify and respond to risks of fraud?</p>	<p>There have been no high risk areas of fraud identified in the current financial year. Fraud is always considered as part of each internal audit. For the audits completed in 2017-18 fraud has not been identified.</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>An isolated incident has occurred which has led to the establishment of a member working group with the action plan to identify and address any potential weaknesses.</p>
<p>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>In order to mitigate fraud occurring the Council has a number of processes in place. 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. 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:</p> <ul style="list-style-type: none"> • Council tax; and • Housing benefit <p>However, there is a dedicated benefits team within the Corporate Finance division which investigates any potential fraud issues. There is also close working with housing inspectors to ensure that any indication of fraud in respect of HB Claimants is considered.</p>
<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>Yes, however following a small number of individuals not following controls an internal control working group has been established</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>There are not any significantly high- risk posts identified. The governance structures and procedures are strong and there is a requirement for declarations of interest at all council and committee meetings.</p>

Fraud risk assessment

Question	Management response
<p>How does the Audit & Governance Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control?</p> <p>What arrangements are in place to report fraud issues and risks to the Audit & Governance Committee?</p>	<p>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.</p>
<p>How does the Council communicate and encourage ethical behaviour of its staff and contractors?</p>	<p>Through induction and mandatory training</p>
<p>How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?</p>	<p>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.</p>
<p>Are you aware of any related party relationships or transactions that could give rise to risks of fraud?</p>	<p>We are not aware of any related party in 2017-18 which would give rise to a risk of fraud.</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>Are you aware of any instances of actual, suspected, or alleged fraud either within the Council as a whole or within specific departments since 1 April 2017?</p>	<p>No, an incident involving not following protocol has been investigated and reported to the committee however this has not been recorded as a fraudulent activity</p>
<p>Are you aware of any whistleblower reports or reports under the Bribery Act since 1 April 2017? If so how does the Audit & Governance Committee respond to these?</p>	<p>No, none</p>

Laws and regulations

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 & Governance 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 & Governance 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 noncompliance 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>What arrangements does the Council have in place to prevent and detect non-compliance with laws and regulations?</p>	<p>The role of the Monitoring Officer includes being responsible for reporting the actual or potential breach of a legal requirement to the Council meeting or Cabinet. Each decision report includes a legal section that the legal team review and provide comment on.</p> <p>The section 151 officer is responsible for preparing the accounting statement in accordance with relevant legal and regulatory requirements.</p>
<p>How does management gain assurance that all relevant laws and regulations have been complied with?</p>	<p>The monitoring officer is responsible for reviewing compliance with laws and regulations</p>
<p>How is the Audit & Governance Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>The Monitoring Officer (or representative) attends Audit and Governance Committee Meetings and advises members on any areas of concern. The monitoring officer annual report has been replaced with an opinion that feeds into the annual governance statement</p>
<p>Have there been any instances of non-compliance or suspected non-compliance with law and regulations since 1 April 2017, or earlier with an on-going impact on the 2017/18 financial statements?</p>	<p>No non-compliance or suspected non-compliance has been identified in 2017/18 that effects either the current year or prior years.</p> <p>There has been no notification from any regulatory bodies of non-compliance with regulations.</p>

Impact of laws and regulations

Question	Management response
What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?	The council identifies this through its internal legal service, audit service and risk register, supported by the Solicitor to the Council and the section 151 officer.
Is there any actual or potential litigation or claims that would affect the financial statements?	There is an ongoing dispute with Amey Wye Valley around amounts due to and from them at the close of the contract for services, so far this has proved favourably to the Council. There are other potential claims in relation to possible Human Rights breaches.
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate noncompliance?	No, none

Going concern

Matters in relation to laws and regulations

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.

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 Audit & Governance Committee to consider.

Going concern considerations

Question	Management response
Does the Council have procedures in place to assess the Council's ability to continue as a going concern?	Yes, the council has a MTFS to 2020/21 in place
Is management aware of the existence of other events or conditions that may cast doubt on the Council's ability to continue as a going concern?	Yes, the budget setting report highlights possible risks and mitigating action
Are arrangements in place to report the going concern assessment to the Audit & Governance Committee?	Yes this forms part of the annual approval of the statement of accounts
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?	Yes they are consistent and updated annually

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?	They are and all decision reports include a financial impact section to reflect these considerations
Have there been any significant issues raised with the Audit & Governance 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, none
Does a review of available financial information identify any adverse financial indicators including negative cash flow? If so, what action is being taken to improve financial performance?	No, none
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, sufficient suitably qualified staff are in post, recruitment is underway for some staff vacancies.

Related parties

Matters in relation to Related Parties

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

A disclosure is required if a transaction (or series of transactions) is material on either side i.e. if a transaction is immaterial from the Council's perspective but material from a related party viewpoint then the Council must disclose it.

ISA (UK&I) 550 requires us to review your procedures for identifying related party transactions and obtain an understanding of the controls that you have established to identify such transactions. We will also carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate.

Related party considerations have been set out below and management has provided its response.

Related parties

Question	Management response
<p>What controls does the Council have 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 • Annual return from senior managers/officers • Review of in-year income and expenditure transactions with known identified related parties from prior year or known history including year end debtors and creditors. • The councils contract's register.
<p>Who have the Council identified as related parties?</p>	<p>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.</p> <p>The Council discloses its related parties under the following headings:</p> <ul style="list-style-type: none"> • Central Government • Members • Officers • Other public bodies (Including Worcestershire County Council, Wye Valley Trust, 2Gether and the Clinical Commissioning Group) • Significant long-term contracts (Including Balfour Beatty and FOSCA UK) • Other organisations (including Hoople, Herefordshire Housing Ltd and West Mercia Energy)

Accounting estimates

Matters in relation to Accounting Estimates

Local Authorities need to apply appropriate estimates in the preparation of their financial statements. ISA (UK&I) 540 sets out requirements for auditing accounting estimates. This 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 identified the transactions, events and conditions that may give rise to the need to 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.

Accounting estimates

Question	Management response
Are management aware of any transactions, events and conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgement?	No significant in house estimates will be included in the accounts, external professional judgements will be used in relation to asset valuation and pension liabilities which are significant.
Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable?	Yes
How is the Audit & Governance Committee provided with assurance that the arrangements for accounting estimates are adequate?	Through regular updates

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?
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
Bad debt provision	The provision will be based on aged and likelihood of settlement	Qualified accountants will use data to calculate the estimate	No	The provision is based on historic patterns, it is difficult to identify an alternative preferred method	No
Overhead allocation	The finance team apportion central support costs to all front line services on a per FTE basis	All support service cost centres are allocated on the basis of FTE within the service.	No	Apportionment bases are reviewed each year to ensure they are equitable	No

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?
PFI	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. 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	The models for the PFI contracts are used to produce the accounts. Assets are valued in line with other PPE assets.	Use of model for calculating PFI payment elements	Valuations are made in line with RICS guidance- reliance on experts	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
Depreciation & Amortisation	Over the asset life	Professional advice on asset life	Yes	Calculated to correctly allocate over the independently assessed life time	No

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 plant & equipment valuations	External experts	Through procurement instructions	Yes	The use of RICS qualified experienced experts support the assumptions used	No, there has been a change in experts used
Estimated remaining useful lives of PPE	External experts	Through procurement instructions	Yes	The use of RICS qualified experienced experts support the assumptions used	No, there has been a change in experts used
Impairments	The property team will notify finance of all incidents that may result in an impairment	Regular meetings	No, unless an impairment is identified	The use of RICS qualified experienced experts support the assumptions used	No, there has been a change in experts used

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?
Provisions for liabilities	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 most significant provision is provided for independently assessed business rate appeals	Estimated settlements are reviewed at the end of each financial year. The insurance provision is periodically reviewed by the council's insurance broker	No
Defined benefit pension amounts and disclosures	Non-teaching staff are members of the Local Government Pensions Scheme, administered by Worcestershire County Council	Rely on the calculations made by the actuary	The actuary of the pensions scheme	Reliance on the expertise of the actuaries of the pension scheme	No
Non adjusting events - events after the Balance Sheet date	A full review of transactions and information available will be completed	System review and, decisions made after the year end and key meeting data	No	Events after the balance sheet date will become apparent to the finance team through the chief finance officer	No



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