

Informing the Audit Risk Assessment for Herefordshire Council 2020/21

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Purpose

The purpose of this report is to contribute towards the effective two-way communication between Herefordshire Council's external auditors and Herefordshire Council's Audit & Procurement 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 & Procurement Committee under auditing standards.

Background

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

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

- General Enquiries of Management
- Fraud,
- Laws and Regulations,
- Related Parties, and
- Accounting Estimates.

Purpose

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

General Enquiries of Management

Question	Management response
<p>1. What do you regard as the key events or issues that will have a significant impact on the financial statements for 2020/21?</p>	<p>The Covid 19 pandemic impacted the 2020/21 financial statements through incurring additional grant funded expenditure, by acting as agent in providing financial support to others and through awarding significantly reduced business rates charges. This is reflected in increased usable reserves as at 31 March 2021 where spend was incurred in 2021/22.</p>
<p>2. Have you considered the appropriateness of the accounting policies adopted by Herefordshire Council? Have there been any events or transactions that may cause you to change or adopt new accounting policies?</p>	<p>There have been no events or transactions in 2020/21 that required a change to or adoption of new accounting policies.</p>
<p>3. Is there any use of financial instruments, including derivatives?</p>	<p>The council invests funds with approved counterparties listed in the treasury management strategy. We borrow funds from the public works loan board. We do not directly use derivatives.</p>

General Enquiries of Management

Question	Management response
4. Are you aware of any significant transaction outside the normal course of business?	Covid 19 resulted in changes to the normal course of business to those directed and funded by central government.
5. Are you aware of any changes in circumstances that would lead to impairment of non-current assets?	No
6. Are you aware of any guarantee contracts?	The council provides a joint operational void guarantee to a new student accommodation block in Hereford city centre due to open in September 2021. As part of the preparation of the statement of accounts we will be assessing whether there are any disclosure requirements needed.
7. Are you aware of the existence of loss contingencies and/or un-asserted claims that may affect the financial statements?	Adjustments have been made for known potential losses

General Enquiries of Management

Question	Management response
<p>8. Other than in house solicitors, can you provide details of those solicitors utilised by Herefordshire Council during the year. Please indicate where they are working on open litigation or contingencies from prior years.</p>	<p>This detail has been provided in an audit working paper</p>
<p>9. Have any of Herefordshire Council's service providers reported any items of fraud, non-compliance with laws and regulations or uncorrected misstatements which would affect the financial statements?</p>	<p>No</p>
<p>10. Can you provide details of other advisors consulted during the year and the issue on which they were consulted?</p>	<p>Treasury management consultants on as part of an ongoing service contract Various Counsel on various matters where required Specialist advisors to support the valuations in the Statement of Accounts including actuarial support and property valuations.</p>

Fraud

Issue

Matters in relation to fraud

ISA (UK) 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 & Procurement Committee and management. Management, with the oversight of the Audit & Procurement 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 & Procurement Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As Herefordshire Council'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 Audit & Procurement Committee regarding its processes for identifying and responding to risks of fraud, and
- communication to employees regarding business practices and ethical behaviour.

We need to understand how the Audit & Procurement Committee oversees the above processes. We are also required to make inquiries of both management and the Audit & Procurement 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 Herefordshire Council's management.

Fraud risk assessment

Question	Management response
<p>1. Has Herefordshire Council assessed the risk of material misstatement in the financial statements due to fraud?</p> <p>How has the process of identifying and responding to the risk of fraud been undertaken and what are the results of this process?</p> <p>How do the Authority's risk management processes link to financial reporting?</p>	<p>Yes, this risk is considered low. All reports to decision-makers and those charged with governance include a financial implications section that is signed-off in advance by the senior managers in the finance team.</p> <p>Significant risks are actively managed through the risk register.</p> <p>The risk of fraud is considered at many points in council process, from contract procurement to processing payments. Internal audit of processes provides comfort that the council has adequate controls in place to prevent and detect fraud. The council also has a counter fraud strategy and counter fraud specialist post.</p> <p>The risk management team is within the corporate centre that includes financial services, each quarter a combined report is presented at Cabinet.</p>
<p>2. What have you determined to be the classes of accounts, transactions and disclosures most at risk to fraud?</p>	<p>This is detailed in our published counter fraud strategy and is reviewed regularly as new potential routes of fraudulent activity are identified. Generally procurement fraud and social care fraud are key fraud risk areas, specifically in response to Covid 19 the inappropriate payment of support grants was a new risk.</p>
<p>3. Are you aware of any instances of actual, suspected or alleged fraud, errors or other irregularities either within Herefordshire Council as a whole or within specific departments since 1 April 2020?</p> <p>As a management team, how do you communicate risk issues (including fraud) to those charged with governance?</p>	<p>Yes, the counter fraud specialist leads this work with internal audit and provides an annual report to the audit and governance committee.</p>

Fraud risk assessment

Question	Management response
<p>4. Have you identified any specific fraud risks?</p> <p>Do you have any concerns there are areas that are at risk of fraud?</p> <p>Are there particular locations within Herefordshire Council where fraud is more likely to occur?</p>	<p>Yes this is completed as part of risk assessment work</p> <p>There are many areas at risk and mitigation action is taken to reduce this risk along with regular sharing of fraud awareness communications</p> <p>The risk is not increased at specific physical locations, 2020/21 saw the majority of council support services being provided remotely. The councils governance and control environment helps to mitigate the risk both in terms of the likelihood and impact.</p>
<p>5. What processes does Herefordshire Council have in place to identify and respond to risks of fraud?</p>	<p>This depends on the risk area however the counter fraud specialist post supports council departments in responding to risks. The counter fraud strategy has a flowchart that summarises this. We also participate in the National Fraud Initiative to ensure any risks of fraud are identified through partnership and data sharing arrangements.</p>

Fraud risk assessment

Question	Management response
<p>6. How do you assess the overall control environment for Herefordshire Council, including:</p> <ul style="list-style-type: none"> the existence of internal controls, including segregation of duties; and the process for reviewing the effectiveness the system of internal control? <p>If internal controls are not in place or not effective, where are the risk areas and what mitigating actions have been taken?</p> <p>What other controls are in place to help prevent, deter or detect fraud?</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>Our approach is set out in the Annual Governance Statement which is reviewed by Audit & Governance Committee following consultation with senior managers across the organisation. The internal audit plan includes reviewing the control environment and can include recommendations for improvements that are followed up.</p> <p>A status report is shared with the audit and governance committee and representative officers are invited to attend.</p> <p>The council also uses an enterprise resource planning system that has access controls and approval requirements to minimise the risk of successful fraud.</p> <p>In addition there are manual controls that include authorisation requirements before transactions can be actioned.</p> <p>There is limited need and ability to do this, weekly management board meetings provide a forum for highlighting & addressing issues that may arise ensuring the overall budget position is not breached.</p>
<p>7. Are there any areas where there is potential for misreporting?</p>	<p>Financial misreporting is unlikely due to the monthly reconciliation processes that are in place.</p>

Fraud risk assessment

Question	Management response
<p>8. How does Herefordshire Council communicate and encourage ethical behaviours and business processes of its staff and contractors?</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>Have any significant issues been reported?</p>	<p>Through the Staff Code of Conduct, Member Code of Conduct, Contract Procedure Rules and Financial Procedure rules. These are regularly reviewed.</p> <p>We also have a staff register of interests and declarations plus a register of gifts and hospitality</p> <p>The council also has a Code of Corporate Governance and whistleblowing policy in place. This is also a single point of contact available to report concerns about fraud.</p> <p>Employees are encouraged to report all concerns and that these will then be dealt with as appropriate.</p> <p>No significant issues have been reported.</p>
<p>9. 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>High risk posts are all posts capable of having significant individual influence/control over resources in the absence of adequate controls and division of duties. Risks are managed through general controls such as division of duties, procedures to manage resources, reporting requirements, IT security arrangements, training and professional qualification requirements, risk based internal auditing activity planning and whistleblowing procedures.</p>

Fraud risk assessment

Question	Management response
<p>10. 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>We are not aware of any related party relationships or transactions that could give rise to instances of fraud.</p> <p>We have a Register of Interests and additional declarations are completed annually. All staff and Members are required to declare any interests with related parties that could impact on their role within the council and also ongoing in any involvement in the procurement of services or where that relationship may have other affects on their work.</p>
<p>11. What arrangements are in place to report fraud issues and risks to the Audit & Governance Committee?</p> <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 has been the outcome of these arrangements so far this year?</p>	<p>Updates are included in the regular internal audit reports and an annual standalone report is also shared.</p> <p>The committee approves the strategy and reviews the action plan.</p> <p>Feedback on strategy improvements from the committee have been actioned this year.</p>

Fraud risk assessment

Question	Management response
12. Are you aware of any whistle blowing potential or complaints by potential whistle blowers? If so, what has been your response?	No
13. Have any reports been made under the Bribery Act?	No

Law and regulations

Issue

Matters in relation to laws and regulations

ISA (UK) 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 & Procurement Committee, is responsible for ensuring that Herefordshire 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 & Procurement 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>1. How does management gain assurance that all relevant laws and regulations have been complied with?</p> <p>What arrangements does Herefordshire Council have in place to prevent and detect non-compliance with laws and regulations?</p> <p>Are you aware of any changes to the Authority's regulatory environment that may have a significant impact on the Authority's financial statements?</p>	<p>Our Constitution sets out the framework to ensure that all officers, key post holders and members are able to fulfil their responsibilities in accordance with legislative requirements. Roles and responsibilities for individual members, the Council, Cabinet and senior officers, along with the executive functions are documented.</p> <p>A formal induction programme for members is undertaken.</p> <p>All reports to member bodies receive financial and legal checks prior to submission to ensure they comply with regulatory requirements.</p> <p>All staff complete mandatory e-learning.</p> <p>There are no changes to the regulatory environment that may have a significant impact on the accounts.</p>
<p>2. How is the Audit & Procurement Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>Through regular reporting on all matters covered by forward plan and audit workplan. Specifically through the Annual Governance Statement and through the planning and reporting of internal audit work.</p> <p>The committee is supported by attendance by the Monitoring Officer and S151 Officer.</p>

Impact of laws and regulations

Question	Management response
3. Have there been any instances of non-compliance or suspected non-compliance with laws and regulation since 1 April 2020 with an on-going impact on the 2020/21 financial statements?	No
4. Is there any actual or potential litigation or claims that would affect the financial statements?	No
5. What arrangements does Herefordshire Council have in place to identify, evaluate and account for litigation or claims?	<p>Through reports to Directorate Management Teams and statutory officers meetings.</p> <p>Responses to formal claims are routed via Legal and all appropriate senior managers (including the Monitoring Officer and S151 Officer) are alerted.</p> <p>Employment settlements are subject to approval via a vires arrangement by the Monitoring Officer and S151 Officer</p>
6. Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	No

Related Parties

Issue

Matters in relation to Related Parties

Herefordshire Council is required to 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 Herefordshire Council;
- 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 Council's perspective but material from a related party viewpoint then the Authority must disclose it.

ISA (UK) 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 Parties

Question	Management response
<p>1. Have there been any changes in the related parties including those disclosed in Herefordshire Council's 2019/20 financial statements?</p> <p>If so please summarise:</p> <ul style="list-style-type: none"> • the nature of the relationship between these related parties and Herefordshire Council • whether Herefordshire Council has entered into or plans to enter into any transactions with these related parties • the type and purpose of these transactions 	<p>No</p>
<p>2. What controls does Herefordshire Council have in place to identify, account for and disclose related party transactions and relationships?</p>	<p>As part of the closedown of accounts a number of processes have been out into place to determine any related parties and the nature of the relationships that exists. This includes reviewing the register of interests declarations and canvassing key staff members to identify any partnerships or other related parties and ensure the appropriate disclosures are reported in the financial statements.</p>

Related Parties

Question	Management response
3. What controls are in place to authorise and approve significant transactions and arrangements with related parties?	Any significant transactions and arrangements with related parties outside of the budgetary framework would require approval in line with financial regulations and the Constitution.
4. What controls are in place to authorise and approve significant transactions outside of the normal course of business?	Any significant transactions and arrangements with related parties outside of the budgetary framework would require approval in line with financial regulations and the Constitution.

Accounting estimates

Issue

Matters in relation to Related Accounting estimates

ISA (UK) 540 (Revised December 2018) requires auditors to understand and assess an entity's internal controls over accounting estimates, including:

- The nature and extent of oversight and governance over management's financial reporting process relevant to accounting estimates;
- How management identifies the need for and applies specialised skills or knowledge related to accounting estimates;
- How the entity's risk management process identifies and addresses risks relating to accounting estimates;
- The entity's information system as it relates to accounting estimates;
- The entity's control activities in relation to accounting estimates; and
- How management reviews the outcomes of previous accounting estimates.

As part of this process auditors also need to obtain an understanding of the role of those charged with governance, which is particularly important where the estimates have high estimation uncertainty, or require significant judgement.

Specifically do Audit & Procurement Committee members:

- Understand the characteristics of the methods and models used to make the accounting estimates and the risks related to them;
- Oversee management's process for making accounting estimates, including the use of models, and the monitoring activities undertaken by management; and
- Evaluate how management made the accounting estimates?

We would ask the Audit & Procurement Committee to satisfy itself that the arrangements for accounting estimates are adequate.

Accounting Estimates - General Enquiries of Management

Question	Management response
1. What are the classes of transactions, events and conditions, that are significant to the financial statements that give rise to the need for, or changes in, accounting estimate and related disclosures?	There is always a need for professional judgement in reporting the value of the councils assets and pension liabilities. Covid-19 and the impact it has had on the value of financial assets volatility is a circumstance that the authority will continue to need to consider and report on within the financial statements.
2. How does the Authority's risk management process identify and addresses risks relating to accounting estimates?	There is a risk that the professional judgement proves different to actual amounts however the frequency of valuations and sensitivity analysis reported minimises the risk and explains the potential outcome to the accounts users.
3. How does management identify the methods, assumptions or source data, and the need for changes in them, in relation to key accounting estimates?	There is regular dialogue between the interested parties and corporate finance team where national and local considerations and their potential impact on estimates and judgements are discussed and considered. The Cipfa Code guidance is always followed.
4. How does management review the outcomes of previous accounting estimates?	A reasonableness and calculation re-performance / reconciliation is completed by the corporate finance team.
5. Were any changes made to the estimation processes in 2020/21 and, if so, what was the reason for these?	None

Accounting Estimates - General Enquiries of Management

Question	Management response
<p>6. How does management identify the need for and apply specialised skills or knowledge related to accounting estimates?</p>	<p>The council procures external expert advice in valuing assets and pension liabilities.</p>
<p>7. How does the Authority determine what control activities are needed for significant accounting estimates, including the controls at any service providers or management experts?</p>	<p>Control is exercised by ensuring the external service providers are independent, appropriately qualified and correctly commissioned.</p>
<p>8. How does management monitor the operation of control activities related to accounting estimates, including the key controls at any service providers or management experts?</p>	<p>Monitoring is completed through regular communications ensuring an agreed approach is adopted and the methodology of the approach is captured.</p>
<p>9. What is the nature and extent of oversight and governance over management's financial reporting process relevant to accounting estimates, including:</p> <ul style="list-style-type: none"> - Management's process for making significant accounting estimates - The methods and models used - The resultant accounting estimates included in the financial statements. 	<p>The nature and extent of the oversight in relation to accounting estimates includes:</p> <ul style="list-style-type: none"> • The agreement of assumptions in advance, including their appropriateness • Verification of the underlying data in advance • The methodology to be used to determine the value of estimates and its appropriateness • Review of the results for reasonableness, including comparative analysis with previous years • Sensitivity of the results to the key assumptions to assess materiality

Accounting Estimates - General Enquiries of Management

Question	Management response
10. Is management aware of transactions, events, conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgement?	No
11. Are the management arrangements for the accounting estimates reasonable?	Yes
12. How is the Audit & Governance Committee provided with assurance that the arrangements for accounting estimates are adequate ?	<p>We quantify the financial impact of estimation and uncertainty and reported to Audit & Governance Committee as part of the Statement of Accounts.</p> <p>We report this risk assessment to the committee and provide them with the opportunity to consider and comment.</p>



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