

Informing the audit risk assessment Rutland County Council 2018/19



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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 and Risk 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 and Risk 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 and Risk 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 and Risk Committee should consider whether these responses are consistent with the 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 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 and Risk 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 and Risk 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 and Risk Committee oversees the above processes. We are also required to make inquiries of both management and the Audit and Risk 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 low. Although there is an on-going risk of fraud being committed against the Council, clear and effective arrangements are in place to prevent and detect fraud. The Council's own assessment of the residual risk of fraud is set out in its Fraud Risk Register. No material instances of fraud have been identified in 2018/19.</p>
<p>How is the Audit and Risk Committee satisfied that the overall control environment is robust? In particular, what processes does the Council have in place to identify and respond to risks of fraud?</p>	<p>The Council has in place strong controls over the sales and purchase ledger in order to prevent fraud. Internal audit carry out work a fraud risk review most years where they will pick potential fraud areas and investigate. They also have regard to fraud risks in their audit of areas like Council Tax and Housing benefit. Internal audit carry out annual reviews of all key financial systems with all reports going to the Chair of the Audit and Risk Committee. A summary of the outcome of all internal audits are reported to the committee.</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>There are no material instances of fraud that have been identified during the year. There are some areas that are inherently at risk from fraud such as:</p> <ul style="list-style-type: none"> • Council Tax • Single person discount <p>A Single Persons Discount review is undertaken annually using an external firm. This results in discounts being removed. The work on the Fraud Risk register did not highlight areas where the Council assesses residual fraud risks as high.</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>Controls are in place to ensure that expenditure cannot be initiated and approved by a single person – segregation of duties and restrictive approval limits within ISFE ensure that this is the case. Internal audit carry out annual reviews of all key financial systems with all reports going to the Chair of the Audit and Risk Committee. A summary of the outcome of all internal audits are reported to the committee.</p>

Fraud risk assessment

Question	Management response
<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>Not aware of any area where there is a potential of override of controls or inappropriate influence over the financial reporting process.</p>
<p>How does the Audit and Risk Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control? What arrangements are in place to report fraud issues and risks to the Audit and Risk Committee?</p>	<p>The Audit and Risk Committee receives the Fraud Risk Register on a periodic basis and an update report from Internal Audit which is a summary of the work completed by Internal Audit. This highlights the number of recommendations made. It also highlights implementation reviews completed and highlights where there are recommendations not implemented.</p> <p>Any frauds identified are reported to the Audit and Risk Committee.</p>
<p>How does the Council communicate and encourage ethical behaviour of its staff and contractors?</p>	<p>Staff Code of practice is available on the Council's intranet along with the whistleblowing policy. All employees are required to read this as part of their induction process.</p>
<p>How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?</p>	<p>The Counter Fraud Policy was updated in year through the Audit and Risk Committee. This and the Whistleblowing Policy encourage employees to report any suspicions of fraud or irregularity, and explains the procedures to follow.</p> <p>This policy is available to all staff via the Council's intranet, and is included as part of the induction programme delivered by the s151 officer for new staff.</p>

Fraud risk assessment

Question	Management response
Are you aware of any related party relationships or transactions that could give rise to risks of fraud?	The Council sets out related party transactions within the annual accounts. Declarations and conflicts of interest are recorded on an annual basis through a return required to be submitted by members. Any additional interests are required to be declared before meetings and on an ad hoc basis throughout the year.
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 2018?	No actual frauds. The Council has received some information regarding a possible Fraud which has been discussed with Internal Audit and the Police
Are you aware of any whistleblower reports or reports under the Bribery Act since 1 April 2018? If so how does the Audit and Risk Committee respond to these?	We are not aware of any whistleblower reports or reports under the Bribery Act since 1 April 2018.

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 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 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>Directors and Heads of Service are responsible for ensuring compliance with laws and regulations in their service areas.</p> <p>The Monitoring Officer is responsible for ensuring the Council is compliant with laws and regulations. The Constitution details these responsibilities.</p> <p>The Monitoring Officer raises awareness on legal requirements at meetings where needed. In addition in terms of any specific legal issues the monitoring officer would get involved at an early stage.</p> <p>Further information on how the Monitoring Officer carries out these responsibilities are detailed in the Constitution.</p> <p>Internal audit work also has regard to compliance with laws and regulations where appropriate.</p>
<p>How does management gain assurance that all relevant laws and regulations have been complied with?</p>	<p>The S151 officer is responsible for preparing the accounting statements in accordance with relevant legal and regulatory requirements.</p> <p>The Monitoring Officer (or representative) attends Audit and Member Standards Committee meetings and advises members on any areas of concern.</p> <p>Assurance is gained through the work of the Monitoring Officer, internal audit, management controls and annual declarations from Heads of Service.</p>
<p>How is the Audit and Risk Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>As above.</p>

Impact of laws and regulations

Question	Management response
Have there been any instances of non-compliance or suspected non-compliance with law and regulations since 1 April 2018, or earlier with an on-going impact on the 2018/19 financial statements?	Not as far as we are aware
What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?	The Monitoring Officer is responsible for identifying and evaluating claims in the first instance. If the Council cannot deal with the claim within internal resources then an external solicitor will be contacted.
Is there any actual or potential litigation or claims that would affect the financial statements?	None as far as we are aware.
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate noncompliance?	No.

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 and Risk Committee to consider.

Going concern considerations

Question	Management response
<p>Does the Council have procedures in place to assess the Council's ability to continue as a going concern?</p>	<p>A review of future revenue streams and a cash flow forecast is undertaken as part of the budget setting process, management assesses whether it will have enough cash to continue to operate and whether there are any known events that might occur that could prevent this.</p> <p>The Council's 5 year MTFP and minimum balances required of £2m also give a benchmark for assessing the risk to Going Concern.</p>
<p>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?</p>	<p>Management is not aware of any events or conditions that may cast doubt on the entity's ability to continue as a going concern.</p>
<p>Are arrangements in place to report the going concern assessment to the Audit and Risk Committee? How has the Audit and Risk Committee satisfied itself that it is appropriate to adopt the going concern basis in preparing the financial statements?</p>	<p>In terms of the going concern we have a Medium Term Financial plan for the period 2019/20 – 2023/24 and this went through a number of Committees including Full Council for approval. Therefore whilst we don't specifically report on the going concern assessment to Audit and Risk Committee we need to take account of the Council's overall Governance process of which Audit and Risk Committee is one element. All Audit and Risk Committee Members will have been part of the process for its compilation and approval. We have also incorporated reference to the new Medium Term Financial Plan in the Statement of Accounts via the narrative statement and AGS.</p>
<p>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>The available financial information does not identify any adverse financial indicators including negative cash flow.</p>

Going concern considerations

Question	Management response
<p>Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?</p>	<p>The Medium Term Financial Plan considered explicitly the impact of Government policy on funding. The plan sets out the likely implications of the Government's Resources Review and other changes to local government finance.</p>
<p>Have there been any significant issues raised with the Audit and Risk 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).</p>	<p>No</p>
<p>Does a review of available financial information identify any adverse financial indicators including negative cash flow? If so, what action is being taken to improve financial performance?</p>	<p>No.</p>
<p>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?</p>	<p>There are sufficient staff in post with appropriate skills and where vacancies have occurred consideration is given to the recruitment of temporary resources.</p>

Related parties

Matters in relation to Related Parties

Health bodies 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
What controls does the Council have in place to identify, account for, and disclose related party transactions and relationships?	A number of arrangements are in place for identifying the nature of a related party and reported value including: <ul style="list-style-type: none">• Maintenance of a Register of interests for Members• Annual declaration of interest• Councillors and officers do not participate in decisions where they are a related party• Annual accounts disclosures for related parties and transactions are reviewed for completeness by senior finance officers
Who have the Council identified as related parties?	No changes are expected to those related parties disclosed in the 2017/18 financial statements.

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 transactions, events and conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgement?	NNDR Appeals
Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable?	Yes
How is the Audit and Risk Committee provided with assurance that the arrangements for accounting estimates are adequate?	Experienced finance staff are responsible for making the estimates and are done so in line with accounting standards.

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.	Valuations are made by the Councils external valuer, Bruton Knowles, in line with RICS guidance on the basis of 5 year valuations with interim reviews.	The valuer is notified of the program of rolling valuations or of any conditions that warrant an interim re-valuation.	Bruton Knowles.	Valuations are made inline with RICS guidance – reliance on expert.	No
Estimated remaining useful lives of PPE.	The following asset categories have general asset lives: <ul style="list-style-type: none"> ■ Buildings 50 to 10 years for garages ■ Vehicles/Plant and Equipment up to 10 years ■ Infrastructure 25 years. 	Consistent asset lives applied to each asset category.	Use the External Valuer for property related assets. Managers provide estimates for vehicles, plant and equipment assets.	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 External Valuers estimates.	No
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"> ■ A full year's charge is made in the year of acquisition. ■ 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.	Use the External Valuer.	Valuations are made inline with RICS guidance - reliance on 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?
Overhead allocation.	The finance team apportion central support costs to services based on the Council's arrangements for accountability and performance.	All support service cost centres are allocated according to the pre agreed bases.	No	Apportionment bases are reviewed each year to ensure equitable.	No
Measurement of Financial Instruments.	Council values financial instruments at fair value by reviewing the principal or active market for valuation. Where there is not an active market the council uses professional services to measure fair value.	Review of the market valuation or advice taken from professionals.	Yes	Take advice from finance professionals.	No
Provisions for liabilities.	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 CIES 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?
Bad Debt Provision.	A provision is estimated using a proportion basis of an aged debt listing.	The finance team and Corporate Debt Team review the aged debt listing and the likelihood of debt being collected before calculating the BDP.	No	Consistent proportion used across aged debt as per the Code.	No
Accruals	The finance team collate accruals of Expenditure and Income. Activity is accounted for in the financial year that it takes place, not when money is paid or received.	Activity is accounted for in the financial year that it takes place, not when money is paid or received.	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
Non adjusting events - events after the Balance Sheet date	S151 Officer makes the assessment. If the event is indicative of conditions that arose after the balance sheet date then this is a non adjusting 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.	Directors and Heads of Service notify the S151 Officer.	This would be considered on individual circumstances.	This would be considered on individual circumstances.	N/A

