

Informing the audit risk assessment Lichfield District Council 2019/20



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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
- 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 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 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

Has the Council assessed the risk of material misstatement in the financial statements due to fraud?

What are the results of this process?

Management response

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. No material instances of fraud have been identified in 2019/20.

How are the Audit 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 in the organisation?

The Council has in place strong controls over the sales and purchase ledger in order to prevent fraud. Internal audit are used to carry out work on overall fraud risk areas including Council Tax and Housing benefit. Internal audit also give an opinion on their work on controls..

Have any specific fraud risks, or areas with a high risk of fraud, been identified and what has been done to mitigate these risks?

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:

- Council Tax
- Single person discount

Lichfield District Council is a participant in the National Fraud Initiative and review matches as they become available (NFI data sets and app check). Lichfield is working with other Local Authorities in a joint procurement of a credit reference agency to identify potential fraud in Council Tax. Capita has been selected as the successful company and mobilisation is to take place in spring 2020.

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)?

Not aware of any area where there is a potential of override of controls or inappropriate influence over the financial reporting process.

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)?

Not aware of any areas where there is a potential for misreporting override of controls or inappropriate influence over the financial reporting process.

Fraud risk assessment (continued)

Question

How does the Audit 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 Committee?

Management response

The Audit and Member Standards Committee receives 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.

The Audit and Member Standards Committee receive copies of all finalised internal reports and finalised implementation reviews carried out. Any frauds identified will be reported to the Audit and Member Standards Committee.

How does the Council communicate and encourage ethical behaviour of its staff and contractors?

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.

How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?

The Whistleblowing Policy encourages employees to report any suspicions of fraud or irregularity, and explains the procedures to follow. This policy is available to all staff via the Council's intranet, and is included as part of the induction programme for new staff.

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 2019?

None.

Are you aware of any whistleblower reports or reports under the Bribery Act since 1 April 2019?
If so how does the Audit Committee respond to these?

We are not aware of any whistleblowing reports or reports under the Bribery Act since 1 April 2019.

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 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

What arrangements does the Council have in place to prevent and detect non-compliance with laws and regulations?
How does management gain assurance that all relevant laws and regulations have been complied with?

Management response

The Monitoring Officer is responsible for ensuring the Council is compliant with laws and regulations. The Constitution notes that these responsibilities cover:

- complying with the law of the land (including any relevant Codes of Conduct);
- complying with any General Guidance issued, from time to time, by the Monitoring Officer;
- making lawful and proportionate decisions; and
- generally, not taking action that would bring the Council, their offices or professions into disrepute. This officer has access to all Council committee reports.

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.

Further information on how the Monitoring Officer carries out these responsibilities are detailed in the Constitution.

How is the Audit Committee provided with assurance that all relevant laws and regulations have been complied with?

The S151 officer is responsible for preparing the accounting statements in accordance with relevant legal and regulatory requirements. The Monitoring Officer (or representative) attends Audit and Member Standards Committee meetings and advises members on any areas of concern.

Have there been any instances of non-compliance or suspected non-compliance with law and regulations since 1 April 2019, or earlier with an on-going impact on the 2019/20 financial statements?

The Monitoring Officer is not aware of any instances of non compliance with laws or regulations that would have an impact on the financial statements.

Impact of laws and regulations (continued)

Question

Management response

What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?

No new litigation claims in year. The process is consistent with the prior year. The Monitoring Officer is responsible for identifying and evaluating claims in the first instance. Up to 1 January 2020, if the Council could not deal with claims in-house then an external solicitor would have been contacted. Post 1 January 2020, any claims will be sent to South Staffordshire District Council Legal Shared Services for legal advice.

Is there any actual or potential litigation or claims that would affect the financial statements?

None that would affect the financial statements.

Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate noncompliance?

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 Committee to consider.

Going concern considerations

Question

Does the Council have procedures in place to assess the Council's ability to continue as a going concern?

Management response

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.

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?

Management is not aware of any events or conditions that may cast doubt on the entity's ability to continue as a going concern.

Are arrangements in place to report the going concern assessment to the Audit Committee?

How has the Audit Committee satisfied itself that it is appropriate to adopt the going concern basis in preparing the financial statements?

In terms of the going concern we have a four year Strategic Plan 2016- 2020 (which has been replaced as of 18 February by a new Strategic Plan 2020-2024) 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 Member Standards Committee we need to take account of the Council's overall Governance process of which Audit and Member Standards Committee is one element. All Audit and Member Standards Committee Members will have been part of the process for its compilation and approval. We have also incorporated reference to the new Strategic Plan in the Statement of Accounts via the narrative statement and AGS.

The Council has a balanced budget in 2020/21. There are funding gaps 2021/22 onwards. However, there are sufficient reserves to balance the budget up to 2025/26. In addition, the Council will be working on efficiency savings to close the gaps.

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?

The Medium Term Financial Strategy is agreed annually and reflects the investment needs required to deliver the Strategic Plan. The Medium Term Financial Strategy makes clear reference to the Strategic Plan as the basis for the financial considerations in setting the Medium Term Financial Strategy. The financial assumptions are therefore consistent with the Strategic Plan. Monitoring Reports in year to Cabinet and Strategic (Overview and Scrutiny) Committee are consistent with the agreed budget.

Going concern considerations (continued)

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 Strategy considered explicitly the government changes in terms of grants. 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 Committee during the year which could cast doubts on the assumptions made?</p>	<p>No, Internal Audit have not raised any significant assurance weaknesses in controls or procedures.</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>The available financial information does not identify any adverse financial indicators including negative cash flow.</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

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 considerations

Question

What controls does the Council have in place to identify, account for, and disclose related party transactions and relationships?

Management response

A number of arrangements are in place for identifying the nature of a related party and reported value including:

- 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 2019/20 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 considerations

Question

Management response

Are the 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 judgment?

The Check, Challenge and Appeal Process and the paucity of information will mean there will be significant estimates and judgement on the level of the appeals provision at 31 March 2021.

Are the management arrangements for the accounting estimates, as detailed in Appendix 1 reasonable?

Yes- Accounting estimates are made by members of the finance team with sufficient skill and knowledge. The finance team at LDC is experienced and there have been no issues in prior year audits surrounding estimates.
Accounting treatment used by the Council is in line with IFRS and the Code of Practice.
The Council has an estates team who are able to validate the estimates for the valuation and asset lives of non current assets.

How is the Audit 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.
Assurance is also provided by internal and external audit.

Appendix 1 - Accounting estimates

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Property plant & equipment valuations.	Valuations are made by Gerald Eve inline with RICS guidance on the basis of 5 year valuations with interim reviews.	Senior Accountancy Assistant notifies the valuer of the program of rolling valuations or of any conditions that warrant an interim re-valuation.	Used Gerald Eve.	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 years ■ Equipment/vehicles 5 years ■ Plant 12 years ■ Infrastructure 40 years. 	Consistent asset lives applied to each asset category.	Used Gerald Eve 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 Gerald Eve's 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.	Used Gerald Eve..	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 fixed bases.	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 based on the advice of their treasury management advisors and other finance professionals.	Take advice from finance 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 an unadjusting event. For these events only a note to the accounts is included, identifying the nature of the event and where possible estimates of the financial effect.	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

