

# Informing the audit risk assessment for Shropshire Council

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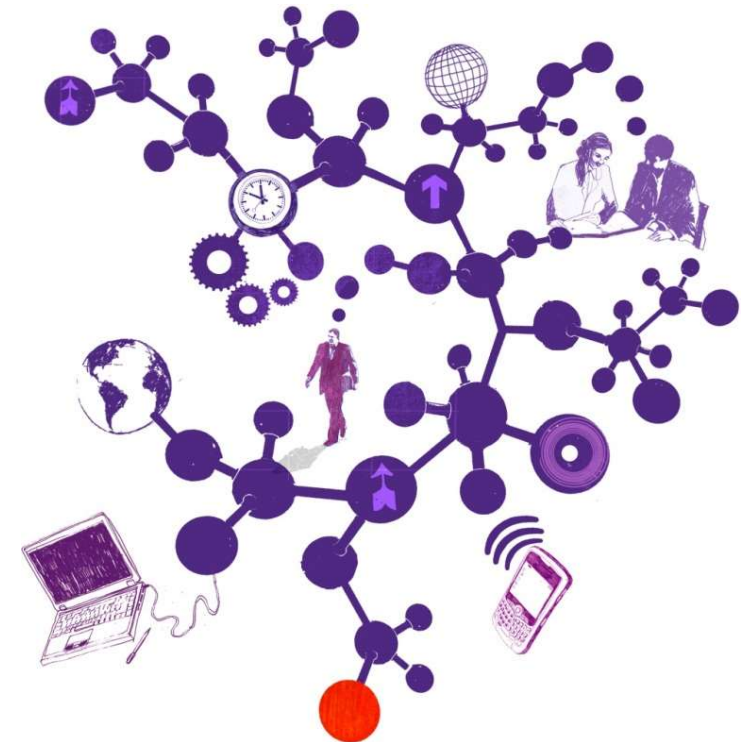
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The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect your business or any weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

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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 party transactions
- 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 its understanding and whether there are any further comments it wishes to make.

# Fraud

## Issue

### Matters in relation to fraud

ISA (UK&I) 240 covers auditors responsibilities relating to fraud in an audit of financial statements.

The primary responsibility to prevent and detect fraud rests with both the Audit Committee and management. Management, with the oversight of the Audit Committee, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of its oversight, the Audit Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error. We are required to maintain professional scepticism throughout the audit, considering the potential for management override of controls. As part of our audit risk assessment procedures we are required to consider risks of fraud. This includes considering the arrangements management has put in place with regard to fraud risks including:

- assessment that the financial statements could be materially misstated due to fraud
- process for identifying and responding to risks of fraud, including any identified specific risks
- communication with the Audit Committee regarding its processes for identifying and responding to risks of fraud
- communication to employees regarding business practices and ethical behaviour.

We need to understand how the Audit Committee oversees the above processes. We are also required to make inquiries of both management and the Audit Committee as to their knowledge of any actual, suspected or alleged fraud. These areas have been set out in the fraud risk assessment questions below together with responses from the Council's management.

# Fraud risk assessment

Question	Management response
<p>Has the Council assessed the risk of material misstatement in the financial statements due to fraud? What are the results of this process?</p>	<p>Fraud risks are identified by Internal audit in their audit plan, and fundamental systems which feed the statement of accounts are reviewed on a risk basis to ensure that controls in place are satisfactory. The statement of accounts is also subject to an analytical review each year which considers any significant or material changes to figures, to confirm that the accounts are presented without such misstatements.</p>
<p>What processes does the Council have in place to identify and respond to risks of fraud?</p>	<p>Specific fraud risks are identified in the audit planning process; in identifying key controls to be assessed as part of an audit; in targeted fraud prevention work and by raising awareness of the potential for fraud with staff, members and people working and involved with the Council. This is done through the Counter Fraud, Bribery and Anti-Corruption Strategy, Speaking up about Wrongdoing Policy, internal and supporting training packages.</p> <p>In addition systems and processes are designed by managers and users to minimise the risk of fraud and corruption. Areas where fraud is more likely to occur reflect nationally targeted areas including procurement with duplicate invoices or contractual frauds; time and resources abuse, payroll and expense claims; housing and council tax benefits; theft of council income; sub-letting of housing property and abuse of subsidised schemes, such as blue badges.</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>No areas with a high risk of material fraud have been identified. If any risks are identified, recommendations for mitigation are made to managers who then implement as necessary.</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>Internal controls, including whether segregation of duties exist, are reviewed by Internal Audit as part of their routine and investigative work; exceptions are reported to managers and inform the Internal audit opinion.</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>There is always the potential for an override of controls within systems, however our control framework has established secondary compensatory controls in place that would identify any such override taking place. Financial reporting is produced and balanced from the financial system, and the reporting hierarchy allows for checks to be performed throughout the process, for example by the Section 151 Officer, Senior Management Team and Cabinet.</p>

# Fraud risk assessment

Question	Management response
Are there any areas where there is a potential for misreporting override of controls or inappropriate influence over the financial reporting process?	No, as detailed above, there are compensatory controls in place to flag any overrides of controls.
How does the Audit Committee exercise oversight over management's processes for identifying and responding to risks of fraud? What arrangements are in place to report fraud issues and risks to the Audit Committee?	The Internal Audit Risk Based Plan is approved by Audit Committee before commencement each year. Internal Audit complete a robust review of internal controls on a risk basis and reports regularly to Audit Committee. Audit Committee are informed of the audit opinions and seek management reassurance on the improvement of controls where the consequences are considered high risk. At each meeting, Audit Committee members receive an update on instances of actual, suspected or alleged fraud investigations that have occurred since the last meeting and their outcomes.
How does the Council communicate and encourage ethical behaviour of its staff and contractors?	The Council shares the whistleblowing policy with the public and all contractors. The terms and conditions within Council contracts also include ethical considerations for contractors and suppliers. The vision and values for the Council identify the need for staff to act with integrity in all the undertakings we make and this is tested and reviewed via team meetings and engagement surveys undertaken across the whole organisation.
How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?	Staff are encouraged to report their concerns about fraud as set out in the Speaking up about wrongdoing (whistleblowing) policy and the Council's Counter Fraud, Bribery and Anti-Corruption Strategy. No significant issues have been reported.
Are you aware of any related party relationships or transactions that could give rise to risks of fraud?	None identified.
Are you aware of any instances of actual, suspected or alleged, fraud within the Council as a whole since 1 April 2016	All investigations of fraud are reported to the Audit Committee with internal audit present to consider the implications of the fraud.

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# Laws and regulations

## Issue

### Matters in relation to laws and regulations

ISA (UK&I) 250 requires us to consider the impact of laws and regulations in an audit of the financial statements.

Management, with the oversight of the Audit Committee, is responsible for ensuring that the Council's operations are conducted in accordance with laws and regulations including those that determine amounts in the financial statements.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error, taking into account the appropriate legal and regulatory framework. As part of our risk assessment procedures we are required to make inquiries of management and the Audit Committee as to whether the entity is in compliance with laws and regulations. Where we become aware of information of non-compliance or suspected non-compliance we need to gain an understanding of the non-compliance and the possible effect on the financial statements.

Risk assessment questions have been set out below together with responses from management.

# Impact of laws and regulations

Question	Management response
What arrangements does the Council have in place to prevent and detect non-compliance with laws and regulations?	Each year the Council's corporate governance arrangements and risk management arrangements are reviewed and reported upon by Internal Audit and Risk Management teams. The Council has a robust corporate governance and risk management process in place.
How does management gain assurance that all relevant laws and regulations have been complied with?	<p>The Council has a Monitoring Officer and Section 151 Officer who provide assurance that all relevant laws and regulations have been complied with. Also all Cabinet reports now have a standard section detailing any legislative issues.</p> <p>Any non compliance is reported to management via Internal Audit reports and appropriate plans are put in place to remedy such issues.</p>
How is the Audit Committee provided with assurance that all relevant laws and regulations have been complied with?	All reports on the Council's corporate governance arrangements are presented to Audit Committee to provide assurance that the appropriate arrangements are in place and that they are working well.
Have there been any instances of non-compliance or suspected non-compliance with law and regulation since 1 April 2016, or earlier with an on-going impact on the 2016/17 financial statements?	The Section 151 Officer is not aware of any instances of non-compliance with relevant laws and regulations in 2017/18.
What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?	Risk management, insurance and legal work together to identify and evaluate any potential litigation or claims against the Council. Any potential liabilities are highlighted each year in the Council's Statement of Accounts.
Is there any actual or potential litigation or claims that would affect the financial statements?	The Section 151 Officer is not aware of any actual or potential litigation or claims that would affect the financial statements.
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	No such reports have been received.



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# Going concern

## Issue

### **Matters in relation to going concern**

ISA (UK&I) 570 covers auditor responsibilities in the audit of financial statements relating to management's use of the going concern assumption in the financial statements.

The going concern assumption is a fundamental principle in the preparation of financial statements. Under this assumption entities are viewed as continuing in business for the foreseeable future. Assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

The code of practice on local authority accounting requires an authority's financial statements to be prepared on a going concern basis. Although the Council is not subject to the same future trading uncertainties as private sector entities, consideration of the key features of the going concern provides an indication of the Council's financial resilience.

As auditor, we are responsible for considering the appropriateness of use of the going concern assumption in preparing the financial statements and to consider whether there are material uncertainties about the Council's ability to continue as a going concern that need to be disclosed in the financial statements. We discuss the going concern assumption with management and review the Council's financial and operating performance.

Going concern considerations have been set out below and management has provided its response.

# Going concern considerations

Question	Management response
Does the Council have procedures in place to assess the Council's ability to continue as a going concern?	The Financial Strategy considers the financial position of the authority over the short, medium and long term and is designed to ensure that the Council continues as a going concern. Internal Audit's work plan provides an on-going review of key elements of the Strategy to ensure its delivery or to highlight at an early stage any unforeseen risks.
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?	No events or conditions have been identified.
Are arrangements in place to report the going concern assessment to the Audit Committee?	The Audit Committee consider a number of financial reports which provide them with assurance that the Council continues as a going concern. These include the Statement of Accounts, Revenue and Capital outturn reports including analysis of reserves held, and Treasury management Strategies. They also receive reports stating that all controls and risks have been managed appropriately and as Members will have access to all reports produced across the Council whether public or exempt.
Are the financial assumptions (eg 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 Financial Strategy considers the financial assumptions for the Council over the short, medium and long term. Each year an exercise considers the robustness of estimates and the adequacy of reserves and provisions which provides assurance to members that the Council's budget plans have been based on the best available information and assumptions. This also provides Audit Committee and Scrutiny Panels, as well as Cabinet and Full Council, the opportunity to comment upon and challenge the approaches taken and implications highlighted. Financial monitoring during the course of the year evaluates any variations from budget plans set out in the Financial Strategy and Budget Book, and also considers the effects that any variance has on the Council's General Fund Balance. This is monitored on a monthly basis and the implications and impacts for future years are updated within the Financial Strategy, reported to Cabinet three times during the year.

# 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 Financial Strategy considers any policy or legislative changes affecting the Council in the short, medium and long term and identifies any financial implications arising from such changes and the Council's plans for mitigation.</p>
<p>Have there been any significant issues raised with the Audit Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).</p>	<p>Although assumptions are regularly challenged by the Audit Committee, no such issues have been raised.</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>Financial monitoring has not identified any such adverse financial indicators.</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>The Council have the relevant expertise to deliver the Council's strategy and objectives. Despite the on-going voluntary redundancy programme, arrangements have been made to retain appropriate experience.</p> <p>The Council also has a performance review process in place to identify any skill requirements within the staff base and identify appropriate training and support in addressing any gaps in knowledge.</p>

# Related parties

## Issue

### Matters in relation to related parties

ISA (UK&I) 550 covers auditor responsibilities relating to related party transactions.

Many related party transactions are in the normal course of business and may not carry a higher risk of material misstatement. However in some circumstances the nature of the relationships and transaction may give rise to higher risks.

For local government bodies, the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) requires compliance with IAS 24: related party disclosures. The Code identifies the following as related parties to local government bodies:

- entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the Council (i.e. subsidiaries)
- associates
- joint ventures in which the Council is a venturer
- an entity that has an interest in the Council that gives it significant influence over the Council
- key officers, and close members of the family of key officers
- post-employment benefit plan (pension fund) for the benefit of employees of the Council, or of any entity that is a related party of the Council.

The Code notes that, in considering materiality, regard should be had to the definition of materiality, which requires materiality to be judged from the viewpoint of both the Council and the related party.

ISA (UK&I) 550 requires us to review your procedures for identifying related party transactions and obtain an understanding of the controls 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

Question	Management response
Who are the Council's related parties?	The Council's related parties include Central Government; organisations on which it is represented by members including Severnside Housing, West Mercia Energy and Shropshire Fire and Rescue Service; and entities which are controlled or significantly influenced by the Authority which includes ip&e Ltd, the Shropshire County Pension Fund and Shropshire Towns and Rural Housing.
What are the controls 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"><li>• Maintenance of a Register of interests for Members, a register for pecuniary interests in contracts for Officers and Senior Managers requiring disclosure of related party transactions.</li><li>• Annual return from senior managers/officers requiring confirmation that they read and understood the declaration requirements and stating details of any known related party interests.</li></ul>

# Estimates

## Issue

### Matters in relation to Accounting Estimates

Local authorities need to apply appropriate estimates in the preparation of their financial statements. Accounting estimates are used when it is not possible to measure precisely a figure in the accounts. ISA (UK&I) 540 sets out requirements for auditing accounting estimates. The objective is to gain evidence that the accounting estimates are reasonable and the related disclosures are adequate.

We need to obtain an understanding of:

- how management identifies the transactions, events and conditions that give rise to the need for an accounting estimate.
- how management actually make the estimates, including the control procedures in place to minimise the risk of misstatement.

We need to be aware of all estimates that the Council is using as part of its accounts preparation. These are set out overleaf. 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.

# Estimate considerations

Estimate	Method	Controls used to identify estimates	Use of an expert	Underlying assumptions - Assessment of degree of uncertainty - Consideration of alternative estimates	Change in accounting method in year?
Property plant & equipment valuations	<p>Full valuation involving an inspection is carried out every 5 years. An impairment and valuation review is carried out as a desk exercise for properties not valued in the year.</p> <p>Other assets are valued on the basis of depreciated replacement cost for specialised properties where there is no market-based evidence of fair value. Depreciated historic cost is used for vehicles, plant and equipment. Historic cost is used for infrastructure, community assets and assets under construction.</p>	Capital Accountant notifies the valuer of the program of rolling valuations or of any conditions that warrant an interim re-valuation.	Use Property Services (RICS valuer) for buildings valuations.	Valuations are made in-line with RICS guidance – reliance on expert. Assumptions are set out in valuer's report.	No
Depreciation & Amortisation	Depreciation is provided for all fixed assets with a finite useful life on a straight-line basis	Consistent application of depreciation method across all assets	No	The asset is not depreciated until it is available for use and each significant part of property, plant and equipment is depreciated separately. Asset lives are determined at acquisition/revaluation. Depreciation is calculated on a straight line basis. The asset lives are recorded in the asset register.	No

# Estimate considerations

Estimate	Method	Controls used to identify estimates	Use of an expert	Underlying assumptions - Assessment of degree of uncertainty - Consideration of alternative estimates	Change in accounting method in year?
Estimated remaining useful lives of PPE	<p>The following useful lives have been used in the calculation of depreciation:</p> <ul style="list-style-type: none"> <li>• Council Dwelling – Major Repairs Allowance has been used as an estimate of depreciation.</li> <li>• Other Land and Buildings – average 10 to 60 years range.</li> <li>• Vehicles, Plant, Furniture &amp; Equipment – average 5 years.</li> <li>• Infrastructure – average 40 years</li> </ul>	<p>Specific asset lives applied to buildings.</p> <p>Consistent asset lives applied to each asset category.</p>	<p>Use Property Services (RICS valuer) for buildings valuations.</p> <p>Other assets considered by Property Services Manager and capital accountant</p>	<p>The length of the life is determined at the point of acquisition or revaluation.</p> <p>Major components are depreciated separately.</p>	No



# Estimate considerations

Estimate	Method	Controls used to identify estimates	Use of an expert	Underlying assumptions - Assessment of degree of uncertainty - Consideration of alternative estimates	Change in accounting method in year?
Impairments	Assets are assessed at the year-end for any indication that an asset may be impaired. An impairment and valuation review is carried out as a desk exercise for properties not valued in the year. The impairment of Housing Revenue Account assets is subject to an annual review of value in line with the requirements of the CLG; this is based on the previous December's house price statistics published by ONS. 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.  This assessment is made by the internal valuer for land and buildings and by Property Services Manager and capital accountant (and other relevant officers for the asset type) for other assets	Use Property Services (RICS valuer) for buildings valuations.	Valuations are made in-line with RICS guidance.	No
Bad Debt Provision.	A provision is estimated using a proportion basis of an aged debt listing.	The finance team obtain the aged debt listings for the sales ledger and the aged debt lists for Council Tax, HRA rents and business rates to calculate the provision.	No	Consistent proportion used across aged debt as per the Code.	No

# Estimate considerations

Estimate	Method	Controls used to identify estimates	Use of an expert	Underlying assumptions - Assessment of degree of uncertainty - Consideration of alternative estimates	Change in accounting method in year?
Accruals	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.	Review financial systems and question service managers to identify where goods have been received but not paid for.	No	Accruals for income and expenditure often based on known values.  Where accruals are estimated the latest available information is used.	No
Provisions for liabilities.	Provisions are made where an event has taken place that gives the Council a legal or constructive obligation that probably requires settlement by a transfer of economic benefits, but where the timing of the transfer is uncertain. 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, 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 considerations

Estimate	Method	Controls used to identify estimates	Use of an expert	Underlying assumptions - Assessment of degree of uncertainty - Consideration of alternative estimates	Change in accounting method in year?
Non adjusting events - events after the BS date	Section 151 Officer makes the assessment. If the event is indicative of conditions that arose after the balance sheet date this is an un-adjusting event. A note to the accounts is included, identifying the nature of the event and where possible estimates of the financial effect.	The Section 151 Officer is notified by relevant managers.	This would be considered on individual circumstances.	This would be considered on individual circumstance.	No
PFI finance lease liability	The operators financial model is used as the basis for calculating the liability.	The operators financial model is used as the basis for calculating entries and this is reviewed by Finance on an annual basis.	No	The construction elements of the annual unitary charge is accounted for as a finance lease. Minimum lease payments are made under these leases and assets recognised under these leases are accounted for using the policies applied generally to such assets, subject to depreciation being charged over the lease term if this is shorter than the asset's estimated useful life.	No
Pension liability	The Council is an admitted body to the Shropshire County Local Government Pension Scheme. The administering authority (the Unitary Council) engage the Actuary who provides the estimate of the pension liability.	Payroll data is provided to the Actuary. Management reconcile this estimate of contributions to the actuals paid out in the year.	Consulting actuary	As disclosed in the actuary's report. Complex judgements including the discount rate used, rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets.	No



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