

# Informing the audit risk assessment for Worcestershire County Council and Pension Fund

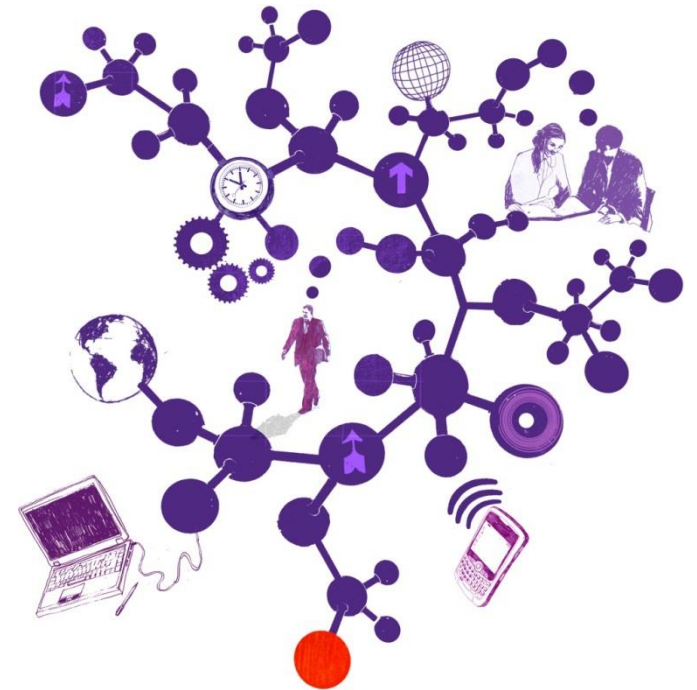
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**Year ended**

31 March 2016

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# Purpose

The purpose of this report is to contribute towards the effective two-way communication between the Authority's external auditors and the Authority's Audit and Governance Committee, as 'those charged with governance'. The report covers some important areas of the auditor risk assessment where we are required to make inquiries of the Audit and Governance Committee under auditing standards.

## Background

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

This two-way communication assists both the auditor and the Audit and Governance Committee in understanding matters relating to the audit and developing a constructive working relationship. It also enables the auditor to obtain information relevant to the audit from the Audit and Governance Committee and supports the Audit and Governance Committee in fulfilling its responsibilities in relation to the financial reporting process.

## Communication

As part of our risk assessment procedures we are required to obtain an understanding of management processes and the Audit and Governance Committee's oversight of the following areas:

- Fraud,
- laws and regulations,
- going concern,
- accounting estimates, and
- related parties.

This report includes a series of questions on each of these areas and the response we have received from the Authority's management. The Audit and Governance 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 and Governance Committee and management. Management, with the oversight of the Audit and Governance Committee, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of its oversight, the Audit and Governance Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

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

# Fraud risk assessment

Question	Management response
<p>1. What is officers' assessment of the risk of material misstatement in the financial statements due to fraud? Is this consistent with the feedback from your risk management processes?</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 both prevent and detect fraud.</p>
<p>2. Are you aware of any instances of fraud, either within the Council as a whole or within specific departments since 1 April 2015?</p> <p>If so how does the Audit and Governance Committee respond to these?</p>	<p>No material instances of fraud have been identified in 2015/16.</p> <p>From time to time internal audit are asked to undertake investigations into alleged fraudulent or inappropriate activity. Often there are recommendations made as a result of these investigations, however they rarely result in clear evidence of fraudulent activity. No significant cases have been identified that represent systematic fraudulent activity.</p>
<p>3. Do you suspect fraud may be occurring, either within the Council or within specific departments? Have you identified any specific fraud risks? Do you have any concerns there are areas that are at risk of fraud? Are there particular locations within the Council where fraud is more likely to occur?</p>	<p>We do not expect material fraud is occurring within the Council. However, evidence published by the National Fraud Authority amongst others, suggests that fraud is committed in all organisations to varying degrees, so it is likely that some fraud is occurring at Worcestershire. In order to mitigate fraud occurring the Council has a number of processes in place.</p> <p>The Internal Audit plan incorporates consideration of potential fraud risks and how these are to be mitigated, for example through the reviews of the Council's key systems and the work it completes on the Council's Anti-Fraud processes to ensure that they are fit for purpose.</p> <p>In addition to this management is expected to identify and record fraud risks where necessary on the corporate risk register.</p>

## Fraud risk assessment (continued)

Question	Management response
<p>4. Are you satisfied that the overall control environment, including: the process for reviewing the system of internal control; internal controls, including segregation of duties; exist and work effectively?</p> <p>If not where are the risk areas?</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>Yes.</p> <p>The Council's management have been asked to state in their Director Assurance Statements that they are not aware of any significant control failures occurring in 2015/16.</p> <p>In addition to segregation of duties, the Council has a number of other control processes in place to prevent, deter or detect fraud, including the use of exception reports to identify unusual transactions which could be fraudulent.</p>
<p>5. How do you encourage, and communicate to employees about your views on business practices and ethical behaviour? How do you encourage staff to report their concerns about fraud? What concerns are staff expected to report about fraud?</p>	<p>A confidential fraud reporting hotline is available for concerns to be reported. To the end of December 2015 seven hundred and eighty six people have undertaken the Internal Fraud e-learning module. The Council's Whistleblowing and Anti-Fraud and Corruption Policies are available on the Intranet. In order to keep abreast with current developments, Internal Audit sends a representative to Midland Counties Chief Internal Auditor group and will be attending the Midlands Fraud Forum in February. CIPFA and Barclays Bank Seminars have also been attended as well as receiving regular updates from the Institute of Internal Auditors.</p>

## Fraud risk assessment (continued)

Question	
<p>6. From a fraud and corruption perspective, what are considered to be high-risk posts? How are the risks relating to these posts identified, assessed and managed?</p>	<p>There are not any significantly high-risk posts identified.</p>
<p>7. Are you aware of any related party relationships or transactions that could give rise to instances of fraud? How do you mitigate the risks associated with fraud related to related party relationships and transactions?</p>	<p>The 2014/15 financial statement disclosure of related party transactions does not identify any potential fraud risk, and none is anticipated in the preparation work for the 2015/16 financial statements. Members and officers are required to make full disclosure of any relationships that impact on their roles. Members are required to declare any relevant interests at Council and Committee meetings.</p>
<p>8. What arrangements are in place to report fraud issues to Audit Committee? How does the Audit Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control?</p>	<p>Internal Audit report to Audit &amp; Governance Committee on a quarterly basis any fraud issues. It is also intended to produce an annual report on Counter fraud work. The Audit and Governance Committee may seek further assurance from Internal Audit or management regarding fraud and breaches of internal control.</p>
<p>9. Are you aware of any whistleblowing reports under the Bribery Act since 1 April 2015? If so how does the Audit and Governance Committee respond to these?</p>	<p>No</p>



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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 and Governance Committee, is responsible for ensuring that the Authority'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 and Governance Committee as to whether the entity is in compliance with laws and regulations. Where we become aware of information of non-compliance or suspected non-compliance we need to gain an understanding of the 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? What arrangements does the Council have in place to prevent and detect non-compliance with laws and regulations?</p>	<p>The role of the Monitoring Officer is defined in the Constitution as "responsible for reporting the actual or potential breach of a legal requirement to the Council meeting or Cabinet."</p> <p>The Monitoring Officer is supported by a team of Legal and Democratic Services Officers who advise him of any matters of concern.</p> <p>The Monitoring Officer sees all reports to the Chief Officer Management Board and all reports to Members.</p> <p>All reports to Members are required to have a legal implications section and a risk section.</p> <p>The section 151 officer is responsible for preparing the accounting statements in accordance with relevant legal and regulatory requirements.</p>
<p>2. How is the Audit Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>The Monitoring Officer (or representative) attends Audit and Governance Committee Meetings when legal issues arise and advises members on any areas of concern.</p>
<p>3. Have there been any instances of non-compliance with law and regulation since 1 April 2015 with and on-going impact on the 2015/16 financial statements?</p>	<p>No</p>
<p>4. Is there any actual or potential litigation or claims that would affect the financial statements?</p>	<p>No</p>
<p>5. What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?</p>	<p>The Council has an internal Insurance Team, under the line management of the S151 Officer, to advise and monitor any litigation / claims. This is in addition to services undertaken by the internal Legal and Democratic services team. Any issues are brought to the attention of the Monitoring Officer and/or S151 Officer as they arise.</p>
<p>6. Have there been any report from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?</p>	<p>No</p>

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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.

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

## Going concern considerations

Question	Management response
1. Has a report been received from management forming a view on going concern?	The Director of Resources, as s151 Officer, is satisfied that the budget proposals are based on robust estimates, and that the level of reserves is adequate. This was reported in the annual Budget report to Cabinet and Council in February.
2. 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 underpins the strategic, transformational and operational intentions for Worcestershire County Council and forms part of the corporate strategic planning process. The financial assumptions are therefore consistent with the Corporate Plan. Reports in year are consistent with the budget set.
3. Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	The financial plan considered the government changes in terms of grant settlement and the financial settlement. The plan is updated to reflect the financial settlement
4. Have there been any significant issues raised with the Audit and Governance Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).	No
5. Does a review of available financial information identify any adverse financial indicators including negative cash flow or poor or deteriorating performance against the better payment practice code? If so, what action is being taken to improve financial performance?	No

## Going concern considerations (continued)

Question	Management response
<p>6. 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>Yes</p>
<p>7. Does the Council have procedures in place to assess the Council's ability to continue as a going concern?</p>	<p>Yes. The Council has a robust corporate planning process, including an annual corporate strategic planning event in September and a change management process involving fortnightly Future Fit Steering Group meetings, a monthly Future Fit Programme Board and weekly Star Chamber call ins to track particular successes or progress against the more difficult milestones. Directors and Cabinet Members are included in this process.</p>
<p>8. Is management aware of the existence of events or conditions that may cast doubt on the Council's ability to continue as a going concern?</p>	<p>Yes management is aware of this, however there are no events or conditions that cast doubt on going concern.</p>
<p>9. Are arrangements in place to report the going concern assessment to the Audit and Governance Committee? How has the Audit and Governance Committee satisfied itself that it is appropriate to adopt the going concern basis in preparing financial statements?</p>	<p>The Council is an organisation which has many statutory responsibilities and functions and as such the financial statements are prepared on a going concern basis. Where any of the Council's functions are changing, these decisions are taken by Cabinet and where appropriate Full Council, matters of which are routinely considered by Audit and Governance Committee members.</p>

# Related Parties

## Issue

### Matters in relation to Related Parties

Local Authorities are required to comply with IAS 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 authority (i.e. subsidiaries);
- 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 Authority perspective but material from a related party viewpoint then the Authority 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.

## Question

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

## Management response

Throughout each year, finance and legal services staff are involved in supporting any detailed partnerships or similar arrangements with other bodies. During the final accounts process, a particular challenge exercise to identify any and all matters in relation to related parties is undertaken. The results of this exercise is included in the financial statements.

# Accounting estimates

Issue
<p><b>Matters in relation to accounting estimates</b></p> <p>Local Authorities apply appropriate estimates in the preparation of their financial statements. ISA (UK&amp;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.</p> <p>Under this standard we have to identify and assess the risks of material misstatement for accounting estimates by understanding how the Authority identifies the transactions, events and conditions that may give rise to the need for an accounting estimate.</p> <p>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 Authority is using as part of its accounts preparation; these are detailed in appendix 1 to this report. The audit procedures we conduct on the accounting estimate will demonstrate that:</p> <ul style="list-style-type: none"> <li>• the estimate is reasonable; and</li> <li>• estimates have been calculated consistently with other accounting estimates within the financial statements.</li> </ul> <p>We would ask the Audit and Governance Committee to satisfy itself that the arrangements for accounting estimates are adequate.</p>

Question	Management response
1. Are 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 (other than those in Appendix A)?	No changes have arisen that could cause a change in significant accounting estimates. Management would be aware of any such circumstances through normal monthly Directorate Management Team finance reports.
2. Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable?	Yes
3. How is the Audit and Governance Committee provided with assurance that the arrangements for accounting estimates are adequate ?	Assumption methodologies are reviewed before the financial statements are prepared, and are detailed for transparency in the accounts publications.

# 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 a qualified valuer ( RICS/CIB Member) in line with RICS guidance on the basis of 5 year valuations with interim reviews.	There is a rolling program of valuations and the finance team issues a terms of engagement covering specific issues for the year	Yes, the valuer is a member of RICS	Valuations are made in-line with RICS guidance - reliance on expert	No
Estimated remaining useful lives of PPE	The following assets categories have general asset lives: <ul style="list-style-type: none"> <li>• Buildings 10-99 years</li> <li>• Vehicles, Plant and machinery 3-10 years</li> <li>• Infrastructure 20 years</li> </ul>	Consistent asset lives applied to each asset category	Use a local RICS member for valuations	The method makes some generalisations. For example, buildings tend to have a useful life of up to 65 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 local qualified RICS Member.	No



## Appendix A Accounting Estimates (Continued)

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?
Depreciation and 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	<p>The length of the life is determined at the point of acquisition or revaluation according to:</p> <ul style="list-style-type: none"> <li>• assets which are bought from a third party are depreciated for a full year in the year of purchase. All other assets created as a result of capital expenditure during the year are depreciated for a full year where appropriate.</li> <li>• Assets under construction, being capital works in progress where the uncompleted asset does not have a material benefit to the County Council, are not depreciated.</li> </ul>	No

## Appendix A Accounting Estimates (Continued)

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?
Impairments	Assets are assessed at each year-end as to whether there is an 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 , here 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 internal local RICS member for valuations.	Valuations are made inline with RICS guidance – reliance on expert	No
Measurement of Financial Instruments	Council values financial instruments at fair value based on the advice of their external treasury consultants	Take advice from professionals	Yes	Take advice from treasury management professionals	No

## Appendix A Accounting Estimates (Continued)

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 allocation basis.	No	Apportionment bases are reviewed each year to ensure they are equitable.	No.
Provisions for liabilities	<p>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 or service potential, and a reliable estimate can be made of the amount of the obligation.</p> <p>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.</p>	Charged in the year that the Council becomes aware of the obligation	No	Estimated settlements are reviewed at the end of each financial year. The insurance provision is periodically reviewed by the council's insurance broker	No

## Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Accruals	Activity is accounted for in the financial year that it takes place, not when money is paid or received.	Procedures for identifying accruals are included in the closedown instructions	No	Accruals for income and expenditure have been principally based on known values. Where accruals have had to be estimated the latest available information has been used.	No

## Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
PFI schemes and similar contracts	<p>PFI and similar contracts are agreements to receive services, where the responsibility for making available or improving the asset to provide the services passes to the PFI contractor. As the Council is deemed to control the services that are provided under its PFI schemes, it carries the assets used under the contracts on its Balance Sheet as part of Property, Plant and Equipment.</p> <p>The original recognition of these assets at fair value (based on the cost to purchase the property, plant and equipment) is balanced by the recognition of a liability for amounts due to the scheme operator to pay for the capital investment.</p>	<p>The models for the PFI contracts are used to produce the accounts.</p> <p>The internal valuer is used for valuations</p>	<p>Use of model for calculating PFI payment elements</p> <p>Use a RICS Member for valuations</p>	<p>Valuations are made in-line with RICS guidance</p> <p>- reliance on expert.</p>	No

## Appendix A Accounting Estimates (Continued)

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?
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 un-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.	Heads of Services notify the S151 Officer	This would be considered on individual circumstances	This would be considered on individual circumstances	N/A
Defined benefit pension amounts and disclosures	Non-teaching staff are members of the Local Government Pensions Scheme, administered by Worcestershire County Council.	Rely on the calculations made by the actuary	The actuary of the pensions scheme	Reliance on the expertise of the actuaries of the pension scheme	No

## Appendix A Accounting Estimates (Continued)

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?
Pension Fund Actuarial Gains/Losses	The actuarial gains and losses figures are calculated by the actuarial experts. These figures are based on making % adjustments to the closing values of assets/liabilities	For the LGPS the Authority responds to queries raised admitted bodies of the pension fund.	The Authority are provided with an actuarial report.	The nature of these figures forecasting into the future are based upon the best information held at the current time and are developed by experts in their field.	No



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