

AGENDA MANAGEMENT SHEET

<i>Name of Meeting</i>	Audit and Ethics Committee
<i>Date of Meeting</i>	27 March 2018
<i>Report Title</i>	Informing the Audit Risk Assessment for Rugby Borough Council
<i>Ward Relevance</i>	Not ward specific
<i>Prior Consultation</i>	Chief Financial Officer (Head of Corporate Resources), Deputy Chief Financial Officer (Financial Services Manager)
<i>Contact Officer</i>	Chris Blundell, Financial Services Manager, Tel: 01788 533410
<i>Report Subject to Call-in</i>	This report is not subject to Call-in
<i>Statutory/Policy Background</i>	The Local Audit and Accountability Act 2014 and, Accounts and Audit Regulations 2015 and The Code of Audit Practice
<i>Summary</i>	This is a report from our appointed external auditor (Grant Thornton) which seeks to ensure that there is effective two-way communication between the Audit and Ethics Committee and the external auditor regarding the risks relating to the 2017/18 external audit of the Council.
<i>Financial Implications</i>	There are no financial implications arising from this report.
<i>Risk Management Implications</i>	There are no risk management implications arising from this report.
<i>Environmental Implications</i>	There are no environmental implications arising from this report.
<i>Equality and Diversity Implications</i>	There are no equality and diversity implications arising from this report.
<i>Legal Implications</i>	There are no legal implications arising from this report.
<i>Recommendation</i>	The committee to confirm that it is satisfied with the arrangements currently in place identified in the appended report.

Reasons for Recommendation

The external auditor has a professional responsibility to ensure that there is effective two-way communication between the auditor and the Council's Audit and Ethics Committee to help reduce the risk of material misstatement.

Audit and Ethics Committee – 27 March 2018

Informing the Audit Risk Assessment for Rugby Borough Council

Report of the Head of Corporate Resources and Chief Financial Officer

Recommendation

The committee to confirm that it is satisfied with the arrangements currently in place identified in the appended report.

Background

Grant Thornton, the Council's appointed external auditor, has submitted a report on the arrangements currently in place to inform the audit risk assessment for the Council. This is appended for consideration.

Name of Meeting: Audit and Ethics Committee
Date of Meeting: 27 March 2018
Subject Matter: Informing the Audit Risk Assessment for Rugby Borough Council
Originating Department: Corporate Resources

LIST OF BACKGROUND PAPERS

There is no list of background papers.



Informing the audit risk assessment for Rugby Borough Council

Year ended 31 March 2018

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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 Ethics 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 Ethics 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 Ethics Committee. ISA(UK&I) emphasise the importance of two-way communication between the auditor and the Audit and Ethics Committee and also specify matters that should be communicated.

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

- fraud
- laws and regulations
- going concern
- accounting estimates
- 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 Ethics 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 Ethics Committee and management. Management, with the oversight of the Audit and Ethics 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 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 and Procurement 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 Ethics Committee oversees the above processes. We are also required to make inquiries of both management and the 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>Has the Authority assessed the risk of material misstatement in the financial statements due to fraud or error? What are the results of this process?</p>	<p>The financial statements are subject to internal quality assurance control checks including : i) checks for high risk activities and ii) analytical reviews with the objective of identifying any significant year on year variances. A risk assessment process related to the preparation of accounts is completed based upon the audit issues raised by both Internal and External Audit. The monthly monitoring of service revenue and capital budgets will identify any risk of material misstatements.</p>
<p>What processes does the Authority have in place to identify and respond to risks of fraud?</p>	<p>The corporate governance framework is reviewed by the Audit and Ethics Committee, for the risk of fraud in relation to the Council's control environment. The Audit and Ethics Committee consider all internal audit reports where there is limited/no assurance, from a control environment and a risk of fraud perspective, this is in line with the agreed audit protocol.</p> <p>The annual report from the Corporate Assurance and Improvement Manager on the adequacy of Internal Control, will also identify fraud risk areas. Investigations of suspected fraud, as a result of cases brought to the attention of the Monitoring Officer, are carried out by the Internal Audit team. The Corporate Assurance and Improvement Manager, keeps the Executive Director and s151 officer informed of any fraud investigations and periodically provides the Audit and Ethics Committee with fraud activity report updates as necessary. In 2016/17 the Corporate Assurance and Improvement Manager completed a full assessment of fraud, bribery and corruption risks across all Council departments and this exercise will be completed again in 2018. The results were reported to the Strategic Risk Management Group and the Audit & Ethics Committee.</p> <p>Fraud, bribery and corruption awareness training is being delivered to all managers in March 2018. The arrangements for the prevention of fraud are considered adequate</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>A full assessment of fraud, bribery and corruption risks was undertaken during 2016/17 and will be completed again in 2018. Where the level of risk was assessed as being Medium or Higher, mitigating actions were identified and recorded. Delivery of these actions is being monitored through the Council's performance management system. The assessment did not identify any specific fraud risks which were rated as being 'High'</p>



Fraud risk assessment continued

Question	Management response
<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>Yes, where segregation of duties cannot be maintained on a person by person basis they are maintained on a process by process basis. Any issues relating to this would be covered within Internal Audit investigations.</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>Thorough budget monitoring carried out by Financial Services would identify any deviations from the Council's policies and procedures. Any retrospective adjustments to expenditure would require one officer to authorise the amendment and a second officer to process the transaction therefore maintaining a segregation of duties.</p>
<p>How does the Audit and Ethics 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 Ethics Committee?</p>	<p>The reporting of fraud issues to Audit and Ethics Committee is made by various Methods: i) Investigation reports by the Corporate Assurance and Improvement Manager as a result of the Whistleblowing Policy ii) Reports by the Head of Corporate Resources and iii) Annual Governance Statement report for Internal Control and includes any fraud risk. Fraud and Corruption are a standing item on the Audit and Ethics Committee Agenda iv) With effect from 2016/17 the Corporate Assurance and Improvement Manager will submit an annual report on counter fraud activity for consideration by the Audit & Ethics Committee.</p>
<p>How does the Authority communicate and encourage ethical behaviour of its staff and contractors?</p>	<p>The updated Code of Conduct for members and employees outlines the Council's expectations for business practice and ethical behaviour. Employees are aware of the antifraud and corruption strategy - details are available on the Intranet. The Corporate Assurance and Improvement Manager investigates all employee concerns for suspected fraud. The Fraud and Corruption Strategy also applies to the Council's contractors in addition to relevant terms and conditions printed on the reverse of any orders that are placed with a contractor. A Fraud Response Plan was developed and approved in February 2017.</p>

Fraud risk assessment continued

Question	
<p>How do you encourage staff to report their concerns about fraud? Have any significant issues been reported ?</p>	<p>The Council has a Confidential Reporting Code which allows employees to report any concerns regarding fraud, unethical behaviour or corruption to the Monitoring Officer or the Corporate Assurance and Improvement Manager. No significant issues have been reported.</p> <p>Furthermore there is a Benefits/Whistleblowing reporting line which is monitored by the Council's Counter Fraud Specialist. These are treated as benefits investigations.</p>
<p>Are you aware of any related party relationships or transactions that could give rise to risks of fraud ?</p>	<p>Most of the related party transactions that could give rise to potential fraud are those in which councillors have a direct interest. Risks are mitigated, by the councillor declarations of interest and non participation in debates linked to these declarations.</p>
<p>Are you aware of any instances of actual, suspected or alleged fraud, either within the Authority as a whole or within specific departments since 1 April 2017 ?</p>	<p>There has been 1 instance of actual, alleged or suspected fraud since 1 April 2017. The case was fully investigated, completed and closed. Fraud and Corruption is reported as a standing item on the Audit and Ethics Committee Agenda.</p>
<p>Are you aware of any whistleblower reports or reports under the Bribery Act since 1 April 2017 ? If so, how has the Finance and Audit and Ethics Committee responded to these ?</p>	<p>No.</p>

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 Ethics 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 Ethics 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 Authority have in place to prevent and detect non-compliance with laws and regulations ?	It is managers' responsibility to ensure that all relevant laws and regulations for their service area are complied with. This requirement forms part of their contract of employment. When a service is audited, one of the areas reviewed is compliance with relevant laws and regulations. Where breaches are identified the Corporate Assurance and Improvement Manager and Monitoring Officer should be informed.
How does management gain assurance that all relevant laws and regulations have been complying with?	The Monitoring Officer will advise the Council's Leadership and Operations team and councillors as appropriate.
How is the Audit and Ethics Committee provided with assurance that all relevant laws and regulations have been complied with ?	Assurance over compliance with the Council's Constitution is provided through the Annual Governance Statement reported to Audit and Ethics Committee.
Have there been any instances of non-compliance or suspected non-compliance with laws and regulations since 1 April 2017, or earlier with an on-going impact on the Authority's 2017/18 financial statements ?	No.
What arrangements does the Authority have in place to identify, evaluate and account for litigation or claims ?	Any potential claims are received by either the Councils' Legal Services team or the Risk Management and Insurance Officer. All claims registered with the latter are passed directly to the Council's insurers.
Is there any actual or potential litigation or claims that would affect the financial statements ?	No.
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance ?	No.

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
Does the Authority have procedures in place to assess the Authority's ability to continue as a going concern ?	<p>The Council achieves this through the aggregation of a number of sources of assurance:</p> <ul style="list-style-type: none"> • A fundamental source of assurance is an updated Medium Term Financial Plan is reported to Cabinet throughout the budget setting process and forms part of the Council Tax Setting process. • The section 151 officer reviews and reports upon the Council's level of reserves annually. • The Council complies with CIPFA's Treasury Management and Prudential Codes when undertaking borrowing and investing. • The Council's HRA business plan is regularly updated.
Is management aware of the existence of other events or conditions that may cast doubt on the Authority's ability to continue as a going concern ?	No.
Are arrangements in place to report the going concern assessment to the Audit and Ethics Committee?	The Council's financial statements are reported directly to and approved independently by the Audit and Ethics Committee. A key aspect of the external audit of the statements is the opinion that the Council remains a going concern, so Audit and Ethics Committee can directly question both the Chief Financial Officer and the External Auditor about any concerns it may have.
Are the financial assumptions in that report (e.g. future levels of income and expenditure) consistent with the Authority's Business Plan and the financial information provided to the Authority throughout the year ?	Yes.
Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern ?	Yes.

Going concern considerations (continued)

Question	Management response
<p>Have there been any significant issues raised with the Audit and Ethics Committee during the year which could cast doubts on the assumptions made ? (Examples include adverse comments raised by Internal 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 in improve financial performance ?</p>	<p>No.</p>
<p>Does the Authority have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Authority's objectives ? If not, what action is being taken to obtain those skills ?</p>	<p>Following the restructuring in the 2016/17 there is appropriate skills and experience at senior manager level to ensure delivery of the Authority's objectives</p> <p>There have been a number of changes within the finance department in the past 6 months, however work is being undertaken to minimise the impact of these changes on the delivery of the Authority's objectives and the preparation of the financial statements.</p>

Related Parties

Issue
<p>Matters in relation to Related Parties</p> <p>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:</p> <ul style="list-style-type: none"> ■ 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. <p>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.</p> <p>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.</p>

Question	Management response
<p>What controls does the Authority have in place to identify, account for and disclose related party transactions and relationships ?</p>	<p>Councillors and officers cannot and do not participate in decisions where they are a related party. Annual accounts disclosures for related parties and transactions are reviewed for completeness by the Financial Services Manager and the Council's Monitoring Officer as part of the Annual Declaration of Interests.</p>

Accounting estimates

Issue

Matters in relation to accounting estimates

Local Authorities apply appropriate estimates in the preparation of their financial statements. 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.

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.

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:

- the estimate is reasonable; and
- estimates have been calculated consistently with other accounting estimates within the financial statements.

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

Question	Management response
Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable ?	Yes. Where estimation is necessary, appropriate estimating methodology is utilised. Estimates will be prepared by those best qualified, e.g. Pension Fund Actuary to supply estimates relating to IAS 19 – Employee Benefits, assets are professionally valued.
How is the Audit and Ethics Committee provided with assurance that the arrangements for accounting estimates are adequate ?	Details of estimates disclosed in accounting policies within Accounts. Audit and Ethics Committee consider this document prior to sign off by the s151 officer.

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 and equipment valuations	Valuations are made by the valuer (local RICS/CIB Member) inline with RICS guidance on the basis of 5 year valuations with interim reviews	Capital Accountant notifies the valuer of the programme of rolling valuations or of any conditions that warrant an interim revaluation	Yes – use of local RICS/CIB Member for valuations.	Valuations are made inline with RICS guidance – reliance on expert	Yes – desktop valuation process used for 2017/18 valuation of housing beacons with indices selected and applied by the valuer
Estimated remaining useful lives of PPE	The following asset categories have general asset lives: <ul style="list-style-type: none"> · Buildings 5-60 years · Equipment/vehicles 3-25 years · Plant 3-25 years · Infrastructure 7-40 years 	Consistent asset lives applied to each asset category.	Yes – use of local RICS/CIB Member for valuations.	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. Overall, the length of life would reflect the views of the qualified RICS or CIB 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	Yes – us of the Local RICS/CIB Member for valuations	The length of the life is determined at the point of acquisition or revaluation 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.	Yes – use of the local RICS/CIB Member for Valuations	Valuations are made in line with RICS guidance – reliance on experts	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 BS date	<p>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.</p> <p>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.</p>	Heads of Service notify the S151 Officer	This would be considered on individual circumstances	This would be considered on individual circumstances	N/A
Measurement of Financial Instruments	Council Values financial instruments at fair value based on the advice of their external treasury consultants and other financial professionals	Take advice from finance Professionals.	Yes – treasury consultants	Take advice from finance 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?
Bad debt provision	A provision is estimated using a proportion basis of an aged debt listing	The Financial Services team calculate the provision	No	Consistent proportion used across aged debt	No
Provision 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 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.	Quarterly monitoring of expected losses. Use of external experts to inform likelihood and magnitude of future losses.	Yes – in relation to the provision for losses from Business Rate Appeals	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

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	Financial Services 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 information has been used.	No
IAS19 Pensions Post Employment Liabilities	Estimation of the pensions liability depends on a number of complex judgements and assumptions relating to the discount rate, the future value of the assets and liabilities of the pension schemes, the rate of increase in pay, changes in retirement ages and mortality rates.	A firm of consulting actuaries is engaged by Warwickshire authorities with expert advice about the assumptions applied.	Yes –Hymans Robertson	This is a major source of estimation. It depends on a number of complex judgements which interact in complex ways. The actuaries model thousands of possible outcomes in order to establish what the world might look like over the long term.	No

