

Communication with the Auditor

Tamworth Borough Council

Audit 2011/12



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Introduction

The purpose of this report is to ensure there is effective two-way communication between the Council's Audit Committee, who are 'those charged with governance' and the Engagement Lead, the Council's external auditor.

1 As your external auditor I have a responsibility under professional auditing standards to ensure there is effective communication with the Audit Committee. This means developing a good working relationship with Committee members, while maintaining my independence and objectivity. If this relationship works well it helps me obtain information relevant to my audit and helps Audit Committee members to fulfil their financial reporting responsibilities. The overall outcome is to reduce the risk of material misstatement.

2 In planning and performing my audit of the financial statements I need to understand how the Audit Committee, supported by the Council's management, meets its responsibilities in the following areas.

- Fraud
- Law and regulation
- Going concern
- Related parties
- Accounting for estimates

3 This report summarises the Audit Committee's, management's and the external auditor's responsibilities in each of these areas, as explained in the International Standards on Auditing (UK and Ireland) (ISAs). My primary responsibility is to consider the risk of material misstatement.

4 Each section of the report includes a series of questions that management have responded to. I would like to ask the Audit Committee to consider these responses to me and confirm that they are satisfied with the arrangements.

Fraud Risk Assessment

5 The ISAs define fraud as:

"An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage."

[ISA (UK&I) 240, paragraph 11]

6 The primary responsibility to prevent and detect fraud is with the Audit Committee and the Council's management. To do this:

- management need to ensure there is a strong emphasis on fraud prevention and deterrence, with a commitment to honest and ethical behaviour; and
- the Audit Committee oversight needs to includes the potential for the override of controls and inappropriate influence over the financial reporting process.

7 As your auditor my overall responsibility is to ensure the Council's financial statements are free from material misstatement due to either fraud or error. I am required to maintain professional scepticism throughout the audit, which means considering the potential for the intentional manipulation of the financial statements.

8 I am also required to carry out a fraud risk assessment to inform my audit approach. This includes considering the following.

- How management assesses the risk of material misstatement in the financial statements due to fraud.
- Management's response to assessed fraud risk, including any identified specific risks.
- How management communicates its process for assessing and responding to fraud risk to the Audit Committee.
- How management communicates its views on ethical behaviour to Officers.
- How the Audit Committee exercises oversight of managements fraud risk assessment and response processes and the internal controls to mitigate these risks.
- What knowledge the Audit Committee has of actual, alleged or suspected fraud.

9 To help me in making my fraud risk assessment management have responded to the following questions.

Table 1: Fraud Risk Assessment

Question	Management Response
1. Management's assessment of the risk of material misstatement in the financial statements due to fraud.	<p>The Section 151 officer receives the following reports to inform his assessment that the financial statements are not misstated due to fraud:</p> <ul style="list-style-type: none">(a) Internal Audit's risk assessment arising from the reviews to inform the Annual Governance Statement;(b) Quarterly reports are received from the Head of Internal Audit Services (HIAS) on systems reviewed (including the key / core financial systems) within the quarter. High risk areas are identified. Follow-up of implementation of control risks are undertaken in a timely manner. HIAS opinion on the system of internal control given quarterly;(c) An Annual Governance Statement - assurance gathering process involves assessing against the objectives, manager's providing assurance statements identifying key control issues affecting their operational processes;(d) External Audit Reports - including the assessment of controls as stated in the Annual Audit & Inspection Letter inform the conclusion on adequacy of the internal control process;(e) Financial Accounts reports / reviews identifying key areas of activity and where appropriate risk implications and variance analysis including the review of draft accounts / analytical review (S151 & Deputy S151) and appropriate working papers where necessary – as part of the quality assessment review;(f) The Final Account Planning & compliance process gives assurance on the key accounting and review processes undertaken in the planned delivery of the final accounts. Copy of implementation plan agreed & monitored by members. The Final Account Delivery Plan (key actions, deliveries, implications & deadlines) identifies key deliverables and issues arising from the preparation process which are reported to CMT & Members;(g) Copy of Final Account documents (including previous year comparators) – material issues / explanations are reported to Audit & Governance

Question	Management Response
	<p>Committee;</p> <p>(h) Advice / information on changes in Accounting Policy that impact on the financial statements (issues affecting comparator variances).</p> <p>(i) Compliance reviews are undertaken to the accounting code of practice (IFRS);</p> <p>External Audit report to the Audit & Governance Committee on their reliance placed on the work of Internal Audit – this therefore increase reliance on standard and quality of audit reports and their reviews of control systems.</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 2011?</p>	<p>Management is made aware of any actual or alleged instances of fraud via the following :-</p> <p>(a) S151 Officer is informed of suspected or alleged areas of fraud from the following sources :-</p> <ul style="list-style-type: none"> - Whistle Blowing / informants, - Benefits Fraud Investigations - Management – identification of irregularities - Internal Audit – reports / reviews <p>Appropriate action is then to investigate all allegations;</p> <p>(b) Any areas of actual fraud will be / are reported to the Audit & Governance Committee as part of the normal quarterly monitoring/reporting process as well senior management and police (were appropriate);</p> <p>c) Requirement of Managers / officers / Members to report to S151 any suspicions / allegations of fraud for appropriate investigation.</p> <p>For the year ended 31st March 2012 there have been no material frauds identified by management or from work undertaken by Internal Audit or Whistle Blowing other than work undertaken by the Benefits Fraud Investigation Unit (Housing Benefits).</p>
<p>3. Do you suspect fraud may be occurring, either within the Council or within specific departments?</p> <p>Have you identified any specific fraud risks?</p> <p>Do you have any concerns there are areas that are at risk of fraud?</p>	<p>No</p> <p>Internal Audit has a fraud risk register updated quarterly. We are aware of areas where fraud has increased e.g. changes to creditor bank details - staff working in this area are also aware of the</p>

Question	Management Response
<p>Are there particular locations within the Council where fraud is more likely to occur?</p>	<p>increased risk. E-learning solution to be rolled out summer 2012.</p> <p>In addition there are not many areas where cash is handled – this happens only at the castle or the TIC and no concerns have been highlighted there.</p>
<p>4. Are you satisfied that internal controls, including segregation of duties, exist and work effectively?</p> <p>What other controls are in place to help prevent, deter or detect fraud?</p>	<p>Yes</p> <p>Other controls include the following:</p> <ul style="list-style-type: none"> - Financial Guidance in place & regularly reviewed and monitored. - Confidential Reporting & Whistle blowing policies in place (reviewed 2012). - System access control at local level. - Monthly financial monitoring & review and exception reporting. - NFI reviews including payments monitoring. - Review of higher value journals. - Segregation of duties / 2 person authorisation requirements (to deter fraud / collusion). - Effective Internal Audit function reviewing key controls. - Internal controls within Services - Self assessments are carried out to identify potential weaknesses.
<p>5. How do you encourage staff to report their concerns about fraud?</p> <p>What concerns are staff expected to report about fraud?</p>	<p>Encouraged via whistle-blowing procedures and/or Anti fraud and corruption strategy - both documents are available on the intranet. These were notified to staff for 2001/11 using netconsent e-mail system which requires response from staff which will be logged and followed up on the system. Staff will be required to complete a short survey to confirm their understanding of the policy and are required to report any concerns. Documents are currently being updated and presented to Audit & Governance Committee for approval in June 2012. Once approved, we will roll out e-learning solution which covers anti fraud and whistle-blowing.</p>
<p>6. From a fraud and corruption perspective, what are considered to</p>	<p>- Senior Management positions (authorisations required).</p>

Question	Management Response
<p>be high-risk posts? How are the risks relating to these posts identified, assessed and managed?</p>	<p>- Treasury Management (Fidelity Guarantee insurance in place). Risks are managed by:</p> <ul style="list-style-type: none"> - Segregation / secondary control check - Monitoring / S151 Officer function - Annual Governance Assurance statement requirements for senior managers - Scheme of Delegation reviews
<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>No.</p> <p>Risks are mitigated by:</p> <ul style="list-style-type: none"> - Annual request to Senior Manager and all Members of the Council for the accounts. - All members have to disclose any interest when making decisions. - Monitoring officer has to keep a register of members interests. - Transparency requirements / publications & public interest disclosures. - There is unlikely to be a risk due to controls over recording relationships and members required to complete annual declarations of interest. Controls over income and expenditure, contracts are deemed to mitigate the risks.
<p>8. What arrangements are in place to report fraud issues to Audit Committee?</p>	<p>Internal Audit provide the Audit Committee with updates of their work on fraud prevention and detection, including any significant identified frauds and the action taken.</p>

Law and Regulation

10 The ISAs (ISA (UK&I) 250) require me to consider the impact that law and regulation and litigation may have on the Council's financial statements. The factors that may result in particular risks of material misstatement due to fraud or error are:

- the operational regulatory framework - this covers the legislation that governs the operations of the Council;
- the financial reporting framework - according to the requirements of International Financial Reporting Standards, the Code of Accounting for Local Authorities in England and relevant Directions;
- taxation considerations - for example compliance with Value Added Tax and Income Tax regulations;
- government policies that otherwise impact on the Council's business;
- other external factors; and
- litigation and claims against the Council.

11 Where I become aware of information about a possible instance of non-compliance I need to gain an understanding of it to evaluate the possible effect on the financial statements.

12 The ISAs also require me to make enquiries of management and the Audit Committee about the arrangements in place to comply with law and regulation. To help me management have responded to the following questions.

Table 2: **Law and Regulation**

Question	Management Response
1. How does management gain assurance that all relevant laws and regulations have been complied with.	a) Quarterly reports are received from the HIAS on systems reviewed. High risk areas are identified; b) The Annual Governance Statement assurance gathering process involves assessing against the objectives and managers providing assurance statements; c) The Monitoring Officer independent reporting on relevant compliance with laws – also attends the Audit & Governance Committee meetings and advises appropriately; d) The External Auditor review and assurance opinion on the financial affairs (management processes) of the Authority s attend all Committee meetings;

Question	Management Response
	<p>e) Re Council & Cabinet reports both the Monitoring Officer & Finance Officer are required (subject to options) to sign – off report prior to members approving recommendations – to identify that proposed actions comply to legislative requirements;</p> <p>f) Periodic update to Officers / Members on new legislative requirements;</p> <p>g) Regular update by external audit on potential compliance issues / understanding;</p> <p>h) Undertaking NFI Anti Fraud initiatives – indicating potential fraudulent violations;</p> <p>i) Pro-active Internal Audit Plan focused on provision of assurance reports on status of management control processes;</p> <p>j) Regular review and update of Financial Guidance and Anti Fraud Policies.</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 Committee meetings 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 2011.</p>	<p>No.</p>
<p>4. Is there any actual or potential litigation or claims that would affect the financial statements.</p>	<p>There are a small number of areas of potential litigation or claims that affect the financial statements for the year ended 31st March 2012.</p> <p>These have been discussed by the Section 151 officer and the external auditor.</p> <p>None of these are considered to be material for the financial statements.</p> <p>The Solicitor to the Council has been requested to identify whether she is aware of any other issues – she has confirmed that none have been identified to date.</p>

Accounting Estimates

13 Local Authorities need to apply appropriate estimates in the preparation of their financial statements. ISA (UK&I) 540 sets out requirements for auditing accounting estimates. The objective is to gain evidence that the accounting estimates are reasonable and the related disclosures are adequate.

14 Under this standard I have to identify and assess the risks of material misstatement for accounting estimates by understanding how the Council identifies the transactions, events and conditions that may give rise to the need for an accounting estimate.

15 Accounting estimates are used when it is not possible to measure precisely a figure in the accounts. We need to be aware of all estimates that the Council are using as part of their accounts preparation; these are detailed in appendix 1 to this report.

16 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.

Related Parties

17 For local government bodies, the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 (the Code) requires compliance with IAS 24: Related party disclosures. Paragraph 3.9.2.5 of 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 authority (i.e. subsidiaries);
- associates;
- joint ventures in which the authority is a venturer;
- 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 plan (pension fund) for the benefit of employees of the authority, or of any entity that is a related party of the authority.

18 Paragraph 3.9.1.3 of 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 authority and the related party.

19 ISA (UK&I) 550 requires me to review your procedures for identifying related party transactions and obtain an understanding of the controls that you have established to identify such transactions. I will also carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate.

Table 3: **Related Parties**

Question	Response
1. Who are the Council's related parties?	The Council has a small number of related parties in which there is a material impact to the financial statements via virtue of - whether the Council might have the potential either to be controlled or influenced by the party or the potential to exert control or influence over the party.
2. What are the controls in place to identify, account for, and disclose, related party transactions and	A number of arrangements are in place for identifying the nature of a related party and reported

Question	Response
relationships?	<p>value including:</p> <p>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.</p> <p>Annual return from senior managers/officers requiring confirmation that read and understood the declaration requirements and stating details of any known related party interests.</p> <p>Review of in-year income and expenditure transactions with known identified related parties from prior year or known history.</p> <p>Review of the accounts payable system and identification of amounts paid to assisted or voluntary organisations.</p>

Appendix 1 Accounting Estimates

Table 4: 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	IFRS Code / RICS guidance	Management review / Chief Accountant / Discussions with External Auditor	Internal Valuer / External Valuer (Calders)	For HRA beacon revaluations an assessment of the initial findings suggested immaterial change.	No (in main) - IFRS
			ICT acquisitions Heritage Assets	ICT purchases at cost Use of valuation (inflated) or cost	Yes - Heritage Assets

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?
Estimated remaining useful lives of PPE	IFRS Code / RICS guidance	Management review / Chief Accountant / Discussions with External Auditor	Internal Valuer	None	No - IFRS / RICS
Depreciation	IFRS Code / Asset manager system - straight line over life (less residual value)	Management review / Chief Accountant / Discussions with External Auditor	Cipfa Asset manager system	None	No - IFRS
Amortisation	IFRS Code / Asset manager system	Management review / Chief Accountant / Discussions with External Auditor	Cipfa Asset manager system	None	No - IFRS
Impairments	IFRS Code / Asset manager system	Management review / Chief Accountant / Discussions with	Cipfa Asset manager system	None	No - IFRS

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?
		External Auditor			
Disposals & Non-current assets held for sale	IFRS Code / RICS guidance & Cipfa Asset manager system	Management review / Chief Accountant / Discussions with External Auditor	Internal Valuer / Cipfa Asset manager system	None	No - IFRS
Non adjusting events - events after the Balance Sheet date	Icelandic deposit receipts - actuals	Management review / Discussions with Sector & External Auditor	None	None	No - in line with LAAP
Overhead allocation	Recharge allocation spreadsheets based on staff time, proportion of office space, employee numbers etc.	Management review	None	None	No

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in-year?
Measurement of Financial Instrument fair values	In line with Code / IFRS - Sector calculations for investments / PWLB for Debt	Management review / Discussions with Sector	Sector / PWLB	None	No - but disclosure now needs to include lease liabilities
Bad Debt Provision	Percentage of debt - based on aged debt outstanding	Management review	None	None	No
Provisions for liabilities	None	Management review / Discussions with External Auditor	N/A	None	No
Accruals	Creditor liability - based on copy invoice / documentation (to	Management review / Accountants check	None	None	No

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in-year?
	check auto accruals over £500 & payments in March / April over £5,000 set minimum level)				
Landfill Allowance liability	N/A	N/A	N/A	N/A	N/A
Finance lease liabilities	IFRS Code / RICS guidance to identify leases / assess & calculate impact	Management review / Discussions with External Auditor	PWC used to assist process for 2010/11 / Internal Valuer	None	No - IFRS
Long term obligations under, for example, PFI	IFRS Code / RICS guidance to identify leases / assess & calculate impact	Management review / Discussions with External Auditor	PWC used to assist process for 2010/11	None	No - IFRS

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?
schemes					
Employment Benefits: -Holiday pay accrual -Termination benefits -Post-employment benefits -Discretionary benefits	Tensor system used Inclusion of voluntary redundancy costs from restructuring in 2010/11 Actuary calculations based on IFRS	Management review / HR Tensor system / Discussions with External Auditor	Human Resources Human Resources / County (pension) Actuary / County	None	No - New system for time recording from 1/1/11 (& annual leave wef 1/4/11) No - IFRS

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?
Defined benefit pension amounts and disclosures	Actuary calculations based on IFRS	Management review / Actuary reports / Discussions with External Auditor	Actuary / County	None	No - IFRS
Contingent Assets	Ex-Kickstart loans	Management review / Discussions with External Auditor	Street UK	Equity Share Loans of c.£90k to be passed to TBC	No - accounted for as deferred capital receipt / Long term Debtor
Contingent Liabilities	small number of potential claims	Management review / Discussions with External Auditor	Yes - External advice being obtained where appropriate	Small reserve to be set aside Small reserve to be set aside	No
NNDR payment to/from	Cipfa spreadsheets / LAAP	Management review	CIPFA	None	No

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in-year?
Government Authority tax surplus/deficit	Assessment of tax liability (See WP)	Management review	None	None	No