

# Communication with the Auditor

Tamworth Borough Council

Audit 2010/11

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# Introduction

**The purpose of this report is to ensure there is effective two-way communication between the Council's Audit & Governance Committee, who are 'those charged with governance' and the District Auditor, 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 & Governance 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 & Governance 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 & Governance 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 & Governance 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 & Governance 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 & Governance 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 & Governance 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 & Governance Committee.
- How management communicates its views on ethical behaviour to Officers.
- How the Audit & Governance Committee exercises oversight of managements fraud risk assessment and response processes and the internal controls to mitigate these risks.
- What knowledge the Audit & Governance 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.	<i>To follow</i>
2. Are you aware of any instances of fraud, either within the Authority as a whole or within specific departments since 1 April 2010?	<i>To follow</i>
3. Do you suspect fraud may be occurring, either within the Authority or within specific departments? <ul style="list-style-type: none"> <li>– Have you identified any specific fraud risks?</li> <li>– Do you have any concerns there are areas that are at risk of fraud?</li> <li>– Are there particular locations within the Authority where fraud is more likely to occur?</li> </ul>	<i>To follow</i>
4. Are you satisfied that internal controls, including segregation of duties, exist and work effectively? <ul style="list-style-type: none"> <li>– If not where are the risk areas?</li> <li>– What other controls are in place to help prevent, deter or detect fraud?</li> </ul>	<i>To follow</i>
5. How do you encourage staff to report their concerns about fraud? <ul style="list-style-type: none"> <li>– What concerns are staff expected to report about fraud?</li> </ul>	<i>To follow</i>
6. From a fraud and corruption perspective, what are considered to be high-risk posts? <ul style="list-style-type: none"> <li>– How are the risks relating to these posts identified, assessed and managed?</li> </ul>	<i>To follow</i>
7. Are you aware of any related party relationships or transactions	<i>To follow</i>

Question	Management Response
<p>that could give rise to instances of fraud?</p> <ul style="list-style-type: none"> <li>– How do you mitigate the risks associated with fraud related to related party relationships and transactions?</li> </ul>	
<p>8. What arrangements are in place to report fraud issues to Audit &amp; Governance Committee?</p>	<p><i>To follow</i></p>

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## 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 Authority;
- 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 Authority.

**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 & Governance 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.	<i>To follow</i>
2. How is the Audit & Governance Committee provided with assurance that all relevant laws and regulations have been complied with.	<i>To follow</i>
3. Have there been any instances of non-compliance with law and regulation since 1 April 2010.	<i>To follow</i>
4. Is there any actual or potential litigation or claims that would affect the financial statements.	<i>To follow</i>



# Going Concern

**13** Going concern' is a key concept in the preparation of the financial statements for the Authority. The accounting concept of going concern refers to the basis of measurement of an organisation's assets and liabilities in its accounts (that is, the basis on which those assets and liabilities are recorded and included in the accounts).

**14** The going concern assumption is a fundamental principle in the preparation of financial statements. 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. If the entity could not continue as a going concern, assets and liabilities would need to be recorded in the accounts on a different basis, reflecting their value on the winding up of the entity. Consequently, assets would be likely to be recorded at a much lower break-up value and medium- and long-term liabilities would become short-term liabilities.

**15** The Authority is not subject to the same future trading uncertainties as private sector entities. However, consideration of the key features of the going concern provides an indication of the Council's financial resilience. It may indicate that some classes of assets or liabilities should not be valued on an ongoing basis.

**16** I discuss the going concern assumption with key Authority officers and review the Council's financial and operating performance. Below are key questions on the going concern assumption which I would like the Audit & Governance Committee to consider.

Table 3: **Going Concern**

Question	Response
1. Has a report been received from management forming a view on going concern?	<i>To follow</i>
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 Authority throughout the year?	<i>To follow</i>

Question	Response
<p>3. Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?</p>	<p><i>To follow</i></p>
<p>4. Have there been any significant issues raised with the Audit &amp; 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).</p>	<p><i>To follow</i></p>
<p>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?</p>	<p><i>To follow</i></p>
<p>6. 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 Council's objectives? If not, what action is being taken to obtain those skills?</p>	<p><i>To follow</i></p>

# Accounting Estimates

**17** 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.

**18** Under this standard I 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.

**19** 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 are using as part of their accounts preparation; these are detailed in appendix 1 to this report.

**20** 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.

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## Related Parties

**21** 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.

**22** 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.

**23** 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 4: **Related Parties**

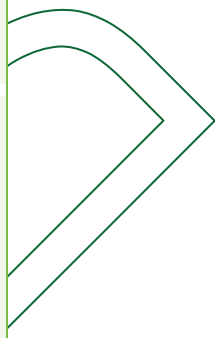
Question	Response
1. Who are the Council's related parties?	<i>To follow</i>
2. What are the controls in place to identify, account for, and disclose, related party transactions and relationships?	<i>To follow</i>

# Appendix 1 Accounting Estimates

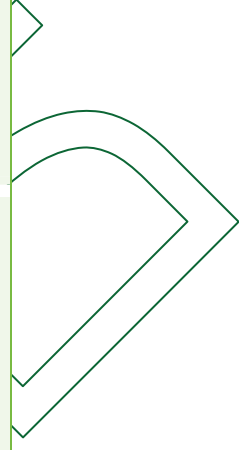
Table 5: Accounting Estimates

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					
Estimated remaining useful lives of PPE					
Depreciation					
Amortisation					
Impairments					
Disposals & Non-current assets held for					

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?
sale					
Non adjusting events - events after the Balance Sheet date					
Overhead allocation					
Measurement of Financial Instrument fair values					
Bad Debt Provision					
Provisions for liabilities					
Accruals					
Landfill Allowance liability					
Finance lease					



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?
liabilities					
Long term obligations under, for example, PFI schemes					
Employment Benefits: -Holiday pay accrual -Termination benefits -Post-employment benefits -Discretionary benefits					
Defined benefit pension amounts and disclosures					
Contingent Assets					
Contingent Liabilities					



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?
NDR payment to/from Government					
Authority tax surplus/deficit					

