



## Auditing Standards – Communication with the Audit Committee

**Cheltenham Borough Council  
Audit year 31 March 2013**

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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 external auditor.

As your external auditors we 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 our independence and objectivity. If this relationship works well it helps us obtain information relevant to our audit and helps Audit Committee members to fulfil their financial reporting responsibilities. The overall outcome is to reduce the risk of material misstatement.

In planning and performing our audit of the financial statements we 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

This report summarises the Audit Committee, 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). Our primary responsibility is to consider the risk of material misstatement.

Each section of the report includes a series of questions that management have responded to.

We would like to ask the Audit Committee to consider these responses and confirm that it is satisfied with the arrangements in place.

# Fraud Risk Assessment

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]

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

- officers 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 include the consideration of the potential for the override of controls and inappropriate influence over the financial reporting process.

As your auditors our overall responsibility is for obtaining reasonable assurance that the Council's financial statements are free from material misstatement due to either fraud or error. We are required to maintain professional scepticism throughout the audit, which means considering the potential for the intentional manipulation of the financial statements.

We are also required to carry out a fraud risk assessment to inform our audit approach. This includes considering the following:

- how management assesses the risk of material misstatement in the financial statements due to fraud
- officers' response to assessed fraud risk, including any identified specific risks
- investigations into data matches identified through the National Fraud Initiative and subsequent outcomes
- how officers communicate the processes for assessing and responding to fraud risk to the Audit Committee
- how officers communicate its views on ethical behaviour to the Audit Committee
- how the Audit Committee exercises oversight of officers' 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.

Table 1 below sets out how officers have responded to our fraud risk assessment.

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**Table 1: Fraud Risk Assessment**

Question	Management response
<p>1. What is management’s assessment of the risk of material misstatement in the financial statements due to fraud?</p> <p>Is this consistent with the feedback from your risk management processes?</p>	<p>The Head of Internal Audit considers that the risk of “customer fraud” is increasing due to ongoing economic pressures, but that the likelihood is still low and the impact should not increase the material misstatement in the financial statements.</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 2012?</p>	<p>There have been no frauds reported to Audit Committee from the Head of Internal Audit for 2012/13. However, there have been “frauds” investigated by the Revenues &amp; Benefits Fraud Team that has resulted in prosecutions or penalties etc.</p> <p>As from June 2013 Internal Audit will be producing an annual Fraud Report for Audit Committee</p>
<p>3. Do you suspect fraud may be occurring, either within the Council or within specific departments?</p> <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 Council where fraud is more likely to occur?</li> </ul>	<p>There is no specific suspicion that fraud is occurring within any council service but Internal Audit have identified areas that are at risk within its Audit Plan and target resources accordingly.</p> <p>As indicated in the response to question 1 there is an increased risk of “fraud” generally and as such Internal Audit has been working with the Benefit Fraud team to establish a Counter Fraud Unit with the specific purpose of pro-actively reducing this risk in 2013/14.</p>
<p>4. Are you satisfied that the overall control environment, including:</p> <ul style="list-style-type: none"> <li>- the process for reviewing the system of internal control;</li> <li>- internal controls, including segregation of duties; exist and work effectively?</li> <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>	<p>The Councils Annual Governance Statement is based upon an annual review of its internal controls and the work of internal audit.</p> <p>The Corporate governance group have considered the governance arrangements in place for each of the councils service areas and One legal provides advice to officers on the separation of duties in respect of decision making.</p> <p>The governance structures within each of the shared services have been</p>

Question	Management response
	<p>designed to ensure that decision making is transparent and based upon sound audit principles.</p> <p>Audit Cotswolds Head of Internal Audit provides the Audit Committee with monitoring reports which provide a level of assurance for the Council and for partners within shared services.</p>
<p>5. How do you communicate to employees about your views on business practices and ethical behaviour?</p> <ul style="list-style-type: none"> <li>- How do you encourage staff to report their concerns about fraud?</li> <li>- What concerns are staff expected to report about fraud?</li> </ul>	<p>SLT receive a reports on the level of compliance on declarations of interest and for returns on Gifts, Hospitality and Sponsorship, areas of weakness are identified and raised with specific Directors and Service managers.</p> <p>Intranet articles highlight the need for declarations of interest to be made and provide advice in respect of offers of Gifts, hospitality and sponsorship.</p> <p>The council's employee and elected Member induction training programmes include the Whistle blowing policy and copies of this policy are available on the intranet which includes examples of the issues that can be reported.</p>
<p>6. From a fraud and corruption perspective, what are considered to be high-risk posts?</p> <ul style="list-style-type: none"> <li>- How are the risks relating to these posts identified, assessed and managed?</li> </ul>	<p>All post holders with budget or cash handling responsibilities are considered to be in positions that could be susceptible to fraudulent activity.</p> <p>Specific high risk posts include the Section 151 and Deputy 151 Officer and cash flow manager. Controls in place through authorisation processes, financial rules, system controls and segregation of duties.</p> <p>The Council has approved a Counter Fraud and Corruption Policy which provides guidance to employees and elected Members of staff on how to prevent and detect unlawful activity.</p>
<p>7. Are you aware of any related party relationships or</p>	<p>Annual returns have not identified</p>

Question	Management response
<p>transactions 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>any third party relationships of transactions that are of concern to management.</p>
<p>8. What arrangements are in place to report fraud issues to Audit Committee?</p>	<p>This aspect has been included in annual opinion reports by the Head of Internal Audit. As from June 2013 there will be a separate report from the Head of Internal Audit on Counter Fraud activity.</p>

## Law and Regulation

Auditing standards (ISA 250) require us 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
- litigation and claims against the Council.

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

The Auditing Standards (ISAs) also require us to make enquiries of management and the Audit Committee about the arrangements in place to comply with law and regulation. To help with this, 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?	The Council's S151 officer Directors and Managers ensure that all legal requirements are met. Assurance is gained from internal controls the audit process, VAT and treasury advisers. All of the reports to Cabinet, Committee and Council include legal financial and HR implications which are completed by the relevant professional officer.
2. How is the Audit Committee provided with assurance that all relevant laws and regulations have been complied with?	The Audit Committee is advised by the Council's S.151 Officer,



Question	Management response
	<p>Internal Audit and the Corporate Governance, Risk and Compliance officer who provide assurance regarding compliance with laws, regulation and financial rules. They bring any issues to the attention of the Committee and provide updates on progress against any appropriate action plans.</p> <p>There is a standard section within all reports to Council, Cabinet and Audit Committee for Legal, Finance and HR to identify the relevant implications and risks.</p>
3. Have there been any instances of non-compliance with law and regulation since 1 April 2012?	No
4. Is there any actual or potential litigation or claims that would affect the financial statements?	None as far as the Council is aware

## Going concern

Going concern is a fundamental principle in the preparation of financial statements. Under the going concern assumption, a council is viewed as continuing in operation for the foreseeable future with no necessity of liquidation or ceasing trading. Accordingly, a councils assets and liabilities are recorded on the basis that assets will be realised and liabilities discharged in the normal course of business. A key consideration of going concern is that the Council has the cash resources and reserves to meet its obligations as they fall due in the foreseeable future.

The Auditing Standards (ISAs) also require us to make enquiries of management and the Audit Committee about the going concern assumption. To help with this, management have responded to the following questions.

**Table 3 – Going concern**

Question	Management response
1. How does management gain assurance that the entity is a going concern	The council is a local authority, receiving annual government grant settlements and contributions as well as taxation and income for goods and services provided. Please refer to the accounting concepts note in the 2012/13 statement of accounts. A balanced and deliverable budget was approved by Council on 8 <sup>th</sup> February 2013 which is reviewed and assessed for robustness by the Section 151 officer.
2. Are the financial assumptions (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? Are there any current adverse financial indicators including negative cash flow	Yes. the budget and annual plan are aligned and are worked on in tandem to ensure funding is available to delivery the councils aspirations.  No. Regular monitoring, of which cabinet is notified formally on a quarterly basis, has not identified any issues.
3. Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern	Yes. The annual preparation process ensures that policy changes are dealt with.
4. 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?	Yes. Capacity is recognised as a Corporate Risk and is identified with the Corporate Risk Register which is

Question	Management response
<p>If not, what action is being taken to obtain those skills?</p>	<p>monitored by SLT on a monthly basis.</p> <p>SLT also receive and consider a Capacity/Resource plan every qtr</p> <p>The annual budget setting process considers any shortfall in staffing capacity and may include request for additional funding to support additional staffing to fulfil objectives e.g. empty properties officer in 2013/14 budget.</p>
<p>5. Have there been any significant issues raised with the Audit Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).</p>	<p>No</p>

## Related Parties

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

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

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

Accounting standards (ISA 550) requires us to review your procedures for identifying related party transactions and obtaining an understanding of the controls that you have established to identify such transactions. We will carry out testing to ensure that the related party transaction disclosures made in the financial statements are complete and accurate.

**Table 3: Related Parties**

Question	Management response
1. Who are the Council's related parties?	These are listed in the 2012/13 statement of accounts. There are not expected to be any major changes to those relating to 2013/14. The main related parties included in the note to the accounts in 2013/14 will include Ubico for the first time. Cheltenham Borough Homes will be reported, as in previous years
2. What are the controls in place to identify, account for, and disclose, related party transactions and relationships?	Annual declarations are signed by individual members and senior officers. These are then reviewed against information available on known related parties, e.g. checked against membership of main organisations. All staff and members are asked to complete a questionnaire, declaring any related parties. If there are any that could lead to risk, the council would not order from or deal with the

Question	Management response
	party concerned.

# Accounting Estimates

Local Government bodies 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.

Under this standard we 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.

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.

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.

## Appendix 1 Accounting Estimates

**Table 5**

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 (PPE) valuations	Valuations are made by an External Valuer (Non Dwellings) and Internal Valuer (Dwellings) in line with RICS guidance. A revaluation of assets is carried out on every 5 year.	Finance team notifies the Valuers of the program of valuations and any conditions that may impact on that valuation.	External Valuation Company/ HRA by Internal Valuers	Valuations are made in-line with RICS guidance with reliance on an expert.	No
	The Valuer's are asked to consider whether there has been any impairments of assets in year	Valuers review assets held and discuss with finance any known events in year which may have impacted on the value.	External Valuation Company/ HRA by Internal Valuers	Valuations are made in-line with RICS guidance with reliance on an expert.	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?
Estimated remaining useful economic life (UEL) of PPE & Depreciation	The remaining UEL of an asset is calculated by the Internal Valuer every 5 years following the RICS guidance. Depreciation is then calculated on a straight line basis in line with IAS 16	The Council uses the information provided by the Valuer for UEL of assets and then uses the standard straight line depreciation formula suggested in ISA 16	Internal Valuation department.	The method makes some assumptions about asset lives and how asset are being used, which by their nature contain a degree of uncertainty because of the long period of time being considered.	No
Pension (IAS 19)	Reliance on information provided by actuary about assumptions on population and future economic growth.	Members and contribution rates are known and shared with actuary. Actuary uses population and economic data to make estimates of future liabilities and assets  Interim navigator reports are provided by the actuary that support the annual estimate of pension liabilities with the annual budget and MTFS.	Pension Actuary	There is a degree of estimation uncertainty as projection of assets and liabilities are over a very long term. However actuary uses most up to date information to make their assumptions. No other alternative estimation techniques have been identified.	No





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