

Informing the audit risk assessment for City of Wolverhampton Council

Year Ended 31 March 2019

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Purpose

The purpose of this report is to contribute towards the effective two-way communication between those charged with governance for City of Wolverhampton Council (“Council”), and Grant Thornton as your external auditor. The report covers some important areas of the auditor risk assessment where we are required to make inquiries to the Council 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 Risk Committee. ISA(UK&I) emphasise the importance of two-way communication between the auditor and the Council and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Audit and Risk 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 Council and supports the Audit and Risk Committee in fulfilling its responsibilities in relation to the financial reporting process.

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

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

This report includes a series of questions on each of these areas and the response we have received from the Council’s management. These responses have been reviewed and agreed by the relevant heads of departments. The Committee should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.

Fraud

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 Risk Committee and the Council management. Management, with the oversight of the Audit and Risk Committee, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of its oversight, the Audit and Risk Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As the Council's external auditors, 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 Risk 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 Risk Committee oversees the above processes. We are also required to make inquiries of both the Council management and the Audit and Risk 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 Council's management.

Fraud risk assessment

Question	Management response
<p>Has the Council assessed the risk of material misstatement in the financial statements due to fraud or error?</p> <p>Is this consistent with the feedback from your risk management processes?</p>	<p>The collective processes for closedown, budget monitoring and outturn take into consideration the risk of material misstatement due to error or fraud. Senior finance officers meet regularly to consider any issues arising from budget monitoring and the closedown process. Should any fraud be reported as part of this or any other process, corrective action would be taken.</p>
<p>Are you aware of any instances of fraud, either within the Council as a whole or within specific departments since 01 April 2018?</p> <p>If so how does the Audit and Risk Committee respond to these?</p>	<p>A report on fraud goes to each of the quarterly Audit and Risk Committee meetings (copies of the reports can be made available upon request).</p> <p>Disciplinary proceedings have been undertaken with an employee in relation to fraud.</p>
<p>Do you suspect fraud may be occurring, either within the Council or within specific departments?</p> <ul style="list-style-type: none"> • Have you identified any specific fraud risks? • Do you have any concerns there are areas that are at risk of fraud? <p>Are there particular locations within the Council where fraud is more likely to occur?</p>	<p>The Council takes into account the findings in publications such as the CIPFA “Fraud Tracker Survey” which identifies fraud trends, and those areas more susceptible to fraud. From this a Fraud Risk Register has been developed, which in turn, is used to inform and drive the Counter Fraud plan.</p> <p>The Council also works closely with Wolverhampton Homes in order to help tackle the risk of Housing Fraud.</p>

Fraud risk assessment (continued)

Question	Management response
<p>Are you satisfied that the overall control environment is robust, including:</p> <ul style="list-style-type: none">• the process for reviewing the system of internal control;• internal controls, including segregation of duties; exist and work effectively? <p>If not where are the risk areas?</p> <p>What other controls are in place to help prevent, deter or detect fraud?</p> <p>Are there any areas where there is a potential for override of controls or inappropriate influence over the financial reporting process (for example because of undue pressure to achieve financial targets)?</p>	<p>Audit Services have given an unqualified opinion on the adequacy and effectiveness of the Council's internal control system for a number of years.</p> <p>Individual internal audit reviews are undertaken in-year, and Audit Services report back, where appropriate, on individual areas where controls could be improved. Recommendations will then be made in order to improve any weaknesses found, and key recommendations are later followed up.</p> <p>They also report any key control weaknesses at each meeting of the Audit and Risk Committee.</p> <p>The Council's Counter Fraud Team which sits within Audit Services incorporates a broad skills base which provides the resources to perform counter fraud and investigation activities and strengthens the council's ability to respond to fraud.</p> <p>There are not any known areas where there is a potential for override of controls or inappropriate influence over the financial reporting process.</p>

Fraud risk assessment (continued)

Question	Management response
<p>How do you encourage, and communicate to, employees about your views on business practices and ethical behaviour?</p> <p>How do you encourage staff to report their concerns about fraud? What concerns are staff expected to report about fraud?</p>	<p>The Council has the following policies and procedures to help raise the awareness of, and combat fraud:</p> <ul style="list-style-type: none">• Anti-Fraud and Corruption Policy and Procedure• Whistleblowing Policy and Procedure• Anti-Money Laundering Policy and Procedure• Raising Fraud Awareness Guide <p>These documents are reviewed annually by the Audit and Risk Committee, and available on the internet. The internet page on fraud has been designed to help strengthen the ease in which potential fraud can be reported on-line</p> <p>Employees learn about business practices and ethical behaviour through the following:</p> <ul style="list-style-type: none">• Codes of Conduct• induction training• accountability arrangements signed by all senior officers• contracts – standard exclusions• adherence to procurement procedures• aide memoires from Monitoring Officer around gifts & hospitality policy at key times of the year. <p>There are a number of fraud related policies and procedures that encourage this, and include full contact details – including a confidential hotline. The Council’s internet site allows on-line reporting.</p>

Fraud risk assessment (continued)

Question	Management response
<p>From a fraud and corruption perspective, what are considered to be high-risk posts?</p>	<p>Senior Officers and Members who have powers to influence decisions are potentially the highest risk posts in respect of fraud and corruption.</p>
<p>How are the risks relating to these posts identified, assessed and managed?</p>	<p>Senior Officers and Members are required to declare interests on a register of interests and at meetings.</p>
<p>Are you aware of any related party relationships or transactions that could give rise to instances of fraud?</p> <p>How do you mitigate the risks associated with fraud related to related party relationships and transactions?</p>	<p>No instances of related party relationships or transactions are known to be fraudulent.</p> <p>Conditions of contact with third parties are in place to mitigate fraud risk, this includes refraining from providing corrupt gifts and payments. The Council's auditors have right of access to third party records if fraud is suspected.</p>
<p>What arrangements are in place to report fraud issues to Audit and Risk Committee?</p> <p>How does the Audit and Risk Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control?</p>	<p>A Counter Fraud Update report is presented to each meeting of the Audit and Risk Committee detailing how the Council is tackling issues around fraud and includes details of any recent investigations into suspected fraudulent activity.</p> <p>The committee also reviews and approves all of the Council's Anti-Fraud Policies and Procedures on an annual basis. This includes a detailed Counter Fraud Plan charting out the actions to be taken going forward, and the Council's Fraud Risk Register.</p> <p>As part of the Annual Internal Audit Plan, Audit Services undertake annual reviews of many of the Council's key financial systems – consideration of fraud forms part of these.</p> <p>The Council also fully participates in the Cabinet Office's National Fraud Initiative, and other national fraud benchmarking exercises, as appropriate.</p>

Fraud risk assessment (continued)

Question	Management response
Are you aware of any whistle-blower reports under the Bribery Act since 01 April 2018? If so how does the Audit and Risk Committee respond to these?	As of today no fraud was reported to us under the Bribery Act since 01 April 2018.

Laws and regulations

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 Council, is responsible for ensuring that the Council'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 Council as to whether the entity is in compliance with laws and regulations. Where we become aware of information of non-compliance or suspected non-compliance we need to gain an understanding of the non-compliance and the possible effect on the financial statements.

Risk assessment questions have been set out below together with responses from management.

Impact of laws and regulations

Question	Management response
<p>How does management gain assurance that all relevant laws and regulations have been complied with?</p> <p>What arrangements does the Council have in place to prevent and detect non-compliance with laws and regulations?</p>	<p>A number of controls are in place. Management place reliance on these controls. In addition, there is an annual programme of work from Audit Services which in part covers legal matters. Directors also meet daily at 09.00 to discuss issues of topical concern including any legal matters. SEB also meets weekly for wider briefings across the business.</p>
<p>How is the Audit and Risk Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>The findings and recommendations from the work of Audit Services, with key issues being reported back to the Audit and Risk Committee. Also, each Director is required to sign an annual assurance statement, and this helps inform the Annual Governance Statement that is reported to the Audit and Risk Committee.</p>
<p>Have there been any instances of non-compliance with law and regulation since 01 April 2018 with on-going impact on the 2018/19 financial statements?</p>	<p>None as at today (26/02/2019).</p>

Impact of laws and regulations (continued)

Question	Management response
Is there any actual or potential litigation or claims that would affect the 2018/19 financial statements?	None as at today (26/02/2019).
What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?	All litigation is commenced / defended / settled in consultation with the Monitoring Officer. All prospective prosecutions are evaluated against nationally adopted criteria. An annual appraisal of contingent liabilities is prepared and reported by the Monitoring Officer in consultation with the Risk Manager.
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	None as at today (26/02/2019).

Going Concern

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
<p>Has a report been received from management forming a view on going concern?</p>	<p>Indirectly through the statement of accounts and regular updates on the Medium Term Financial Strategy.</p>
<p>Are the financial assumptions in that report (e.g., future levels of income and expenditure) consistent with the Council Business Plan and the financial information provided to the Council Authority throughout the year?</p>	<p>During the financial year, Strategic Finance support Budget Managers to conduct regular budget monitoring and to forecast each service's outturn for the year. Throughout this process financial assumptions about the current year and future years are discussed and scrutinised by Budget Managers and Strategic Finance, with quarterly forecast outturn updates provided to the Council's Cabinet (Resources) panel. The Council's Medium Term Financial Strategy is an extension of this budget monitoring and forecasting process; any developments or pressures arising as a result of discussions with Budget Managers during the regular budget monitoring process will be incorporated into the Council's Medium Term Financial Strategy, which is also reported to Cabinet.</p>
<p>Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?</p>	<p>Yes, these are fully reflected in the MTFS as budget pressures.</p>
<p>Have there been any significant issues raised with the Audit and Risk 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>None as of today (26/02/2019).</p>

Going concern considerations (continued)

Question	Management response
<p>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>No adverse financial indicators are currently being reported.</p>
<p>Does the Council have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Council's objectives? If not, what action is being taken to obtain those skills?</p>	<p>Despite the significant challenges being faced by the Council we believe that this is currently the case. In addition resources and structures remain under constant review so in the event that any issues are identified these would be addressed quickly.</p>
<p>Does the Council have procedures in place to assess the Council ability to continue as a going concern?</p>	<p>The MTFS in the main provides this assurance, insofar as it demonstrates that the Council is able to deliver services and statutory responsibilities within the projected available resources. Account is, however, also taken of the potential and contingent liabilities that are reported in the statement of accounts, in order to ensure that assets remain sufficient to meet liabilities.</p>
<p>Is management aware of the existence of events or conditions that may cast doubt on the Council ability to continue as a going concern?</p>	<p>None as of today (26/02/2019).</p>
<p>Are arrangements in place to report the going concern assessment to the Audit and Risk Committee?</p>	<p>Indirectly through the statement of accounts.</p>

Related Parties

Matters in relation to Related Parties

Local Government bodies are required to comply with IAS 24 and disclose transactions with entities/individuals that would be classed as related parties. These may include:

- entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the Council (i.e. subsidiaries);
- associates;
- joint ventures;
- an entity that has an interest in the Council that gives it significant influence over the Council;
- 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 Council, or of any entity that is a related party of the Council.

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 Council's perspective but material from a related party viewpoint then the Council must disclose it.

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

Related Parties considerations

Question	Management response
Who have the Council identified as related parties?	<p>The Council has a number of related parties which are disclosed in the financial statements.</p> <p>The Council owns three other organisations YOO Recruit Ltd, Wolverhampton Homes Ltd and City of Wolverhampton Housing Company Limited (aka Wolverhampton Living).</p> <p>In addition councillors serve on the boards or governing bodies of various local organisations.</p>
What are the controls in place to identify, account for, and disclose, related party transactions and relationships?	<p>Forms re-devised to have prompts including aide-memoire to disclose Directorships</p> <p>Letters to all councillors (or emails as appropriate) to remind them annually to update interests</p> <p>Ability for councillors and officers to now update interests in “real-time” on-line through Modern.gov platform from home or wherever that have internet connectivity, and these are requested to be reviewed and updated on a periodic basis by the Council’s Monitoring Officer.</p>

Accounting estimates

Matters in relation to accounting estimates

Local government bodies 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 is using as part of its accounts preparation; these are detailed in Appendix A 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 Council to satisfy itself that the arrangements for accounting estimates are adequate.

Accounting estimates considerations

Question	Management response
Are management aware of transactions, events and conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgement?	None as of today (26/02/2019).
Are the management arrangements for the accounting estimates, as detailed in Appendix A, reasonable?	Accounting estimates are kept under review throughout the year by Corporate Finance, but formally reviewed each year by the Director of Finance in preparation of the financial statements. The outcome of this formal review is reflected in this document (Appendix A), which is presented to the Audit and Risk Committee in March each year. This Committee provides the opportunity for challenge and any queries.
How is the Audit and Risk Committee provided with assurance that the arrangements for accounting estimates are adequate?	Please see above.

Appendix A – Accounting Estimates

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?
Valuation of property plant and equipment	<p>Dwellings- re-valued every 5 years on an existing use-social housing basis by the District Valuer.</p> <p>Other land and buildings including investment properties and surplus assets:</p> <ul style="list-style-type: none"> • over £1m, valued annually at fair value or depreciated replacement cost. • under £1m, valued as part of a 5 year rolling programme at fair value or depreciated replacement cost. <p>Since 2015-16, external valuers have been used whereas in prior years this was carried out using the Council's in-house valuers.</p> <p>Community assets, vehicles, plant and equipment, infrastructure and assets under construction-depreciated historical cost.</p> <p>Intangibles- at amortised cost</p>	<p>The asset revaluations are critically reviewed by the corporate finance team with any significant variances from previous valuations or our expectations queried and discussed with the valuers.</p> <p>In the period between valuations a review is carried out annually based on appropriate indices or changes in market conditions to establish whether there has been any material change in the asset values.</p>	Yes – external valuer	Valuations are carried out in accordance with RICS guidance and the Code of Practice on Local Authority Accounting.	No

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?
Depreciation of property plant and equipment	Based on the useful economic life of the asset.	Useful economic life is assessed when valuations are carried out. In addition a list of assets is sent to service managers annually to obtain an update on dilapidated or damaged assets.	Yes – external valuer	The valuer is appropriately professionally qualified.	No
Impairment of property plant and equipment	Impairments are determined as a result of the valuation process and as a result of information provided by members of Strategic Finance, Risk and Insurance and Corporate Landlord.	Critical review of asset valuations and review of market conditions.	Use of external valuer and internal RICS qualified staff.	Valuations are made in line with RICS guidance and the Code of Practice on Local Authority Accounting.	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?
Expected credit losses	Expected credit losses are recognised on all financial assets held at amortised cost (or where relevant Fair Value through Other Comprehensive Income (FVOCI)). Impairment losses are calculated to reflect the expectation that the future cash flows might not take place because the borrower could default on their obligations.	Critical review of credit risk and debt collection rates from information provided by the Debt Management Team, Finance and trend analysis.	No	Collection rates, historically, have been relatively constant and level of bad debt write-offs in prior years indicate that the provision is adequate.	No
Provision for liabilities	Provisions are made where an event has taken place which gives the Council a legal or constructive obligation that probably requires settlement by a transfer of economic benefits and a reliable estimate can be made.	Legal liabilities. Insurance. Non Domestic Rates. Equal Pay	No	Charged in the year the Council becomes aware of the obligation.	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?
Accumulated absence account	Accrual is based on outstanding leave as at 31 March 2018 derived from payroll records.	Reasonableness check based on overall number of days outstanding and prior year comparison	No	The accrual is based on actual leave records for individual employees.	No
Liabilities under PFI schemes	The accounting entries are derived from the PFI accounting models which were prepared, based on the operators financial model, at the commencement of the various schemes.	Models are updated annually from information provided by finance and operational staff.	No	Assumption that there has been no significant change to the parameters in the model. If significant changes are identified the model will be amended to reflect the changes.	No

