

# Communication with the Audit & Risk Committee Wolverhampton City Council

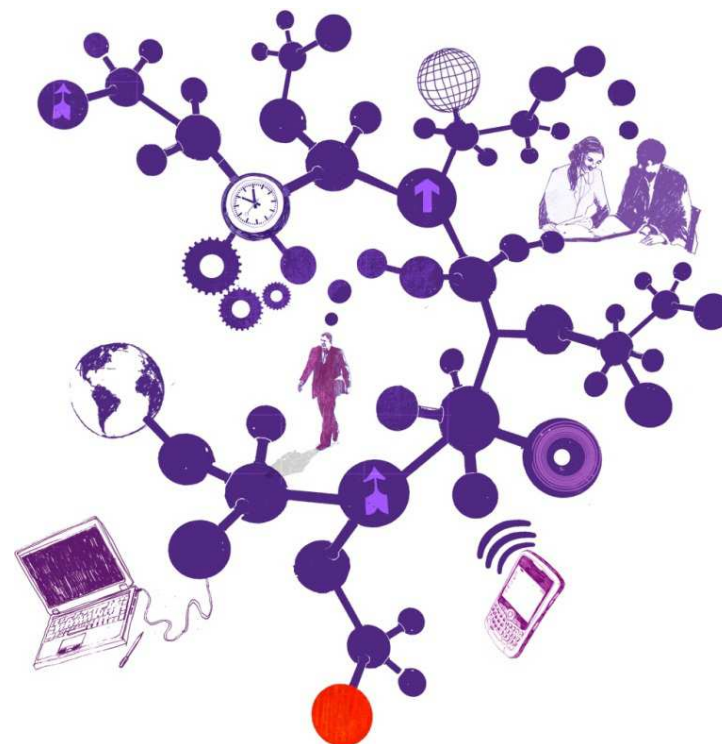
**Year ended 31 March 2016**

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# Purpose

The purpose of this report is to contribute towards the effective two-way communication between auditors and the Council's Audit & Risk 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 & Risk 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 & Risk Committee. ISA(UK&I) emphasise the importance of two-way communication between the auditor and the Audit & Risk Committee and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Audit & 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 Audit & Risk Committee and supports the Audit & 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 management processes and the Audit & 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. We ask the Audit & Risk Committee to consider whether these responses are consistent with the 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 & Risk Committee and management. Management, with the oversight of the Audit & 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 & Risk Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As 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 & 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 & Risk Committee oversees the above processes. We are also required to make inquiries of both management and the Audit & 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
Has the Council assessed the risk of material misstatement in the financial statements due to fraud?	<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>
What processes does the Council have in place to identify and respond to risks of fraud?	<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"> <li>• Anti-Fraud and Corruption Policy and Procedure</li> <li>• Whistleblowing Policy and Procedure</li> <li>• Anti-Money Laundering Policy and Procedure</li> <li>• Raising Fraud Awareness Guide</li> </ul> <p>These documents are reviewed annually by the Audit and Risk Committee, and available on the internet. The internet page on fraud is currently under development to help strengthen the ease in which potential fraud can be reported on-line.</p> <p>The Council has a Client Lead Fraud Officer who sits within Audit Services, and is supported by a joint fraud arrangement with a neighbouring authority.</p> <p>A series of raising fraud awareness seminars and fraud surgeries have recently been run across the Council, and a fraud app is being developed following a successful bid for DCLG funds through Intec.</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. 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 nation fraud benchmarking exercises, as appropriate.</p>

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# Fraud risk assessment

Question	Management response
<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>The Council takes into account the findings in publications such as “Protecting the Public Purse” which identifies fraud trends, and those areas more susceptible to fraud. From this Fraud Risk Register has been developed, which in turn, is used to inform and drive the Counter Fraud plan referred to above.</p> <p>The Council also works closely with Wolverhampton Homes in order to help tackle the risk of Housing Fraud.</p>

# Fraud risk assessment

Question	Management response
<p>Are internal controls, including segregation of duties, in place and operating effectively?</p> <p>If not, where are the risk areas and what mitigating actions have been taken?</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>Audit Services have also been heavily involved in helping to develop the control framework operating within the new Agresso system.</p> <p>They also report any key control weaknesses at each meeting of the Audit and Risk Committee.</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>None that we are aware of.</p>
<p>Are there any areas where there is a potential for misreporting override of controls or inappropriate influence over the financial reporting process?</p>	<p>None that we are aware of.</p>



# Fraud risk assessment

Question	Management response
<p>How does the Audit &amp; Risk Committee exercise oversight over management's processes for identifying and responding to risks of fraud?</p> <p>What arrangements are in place to report fraud issues and risks to the Audit &amp; Risk Committee?</p>	<p>As above, the Audit and Risk Committee receive a Counter Fraud Update Report, and details of any recent investigations into suspected fraudulent activity at each committee meeting. The committee also reviews and approves all of the Council's Anti-Fraud Policies and Procedures on an annual basis.</p>
<p>How does the Council communicate and encourage ethical behaviour of its staff and contractors?</p>	<ul style="list-style-type: none"> <li>• Codes of Conduct</li> <li>• Induction training</li> <li>• Accountability arrangements signed by all senior officers</li> <li>• Contracts – standard exclusions</li> <li>• Adherence to procurement procedures</li> <li>• Aide memoires from Monitoring Officer around gifts &amp; hospitality policy at key times of the year.</li> </ul>
<p>How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?</p>	<p>As above, there are a number of fraud related policies and procedures that encourage this, and include full contact details – including a confidential hotline. A fraud reporting app is being developed and the Council's internet site allows on-line reporting.</p>
<p>Are you aware of any related party relationships or transactions that could give rise to risks of fraud?</p>	<p>None that we are aware of.</p>
<p>Are you aware of any instances of actual, suspected or alleged, fraud, either within the Council as a whole or within specific departments since 1 April 2015?</p>	<p>Yes, a report on these goes to each Audit and Risk Committee (copies of the reports can be made available upon request). However, there are none that would be viewed as material.</p> <p>A recent successful prosecution against a case of internal fraud was featured on the BBC's "Saints and Scroungers" television programme.</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 & Risk Committee, 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 Audit & Risk 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 Council have in place to prevent and detect non-compliance with laws and regulations?	The Council has a number of processes in place to prevent and detect non-compliance with law and regulations. Legal briefing papers are circulated on new developments in law quarterly. Where officers have concerns or queries they are able to discuss these with Legal Services. In addition, a number of policies are in place to ensure compliance. These include the Money Laundering Policy and Whistleblowing policy.
How does management gain assurance that all relevant laws and regulations have been complied with?	A number of controls are in place. Management place reliance on the controls detailed above. 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.
How is the Audit & Risk Committee provided with assurance that all relevant laws and regulations have been complied with?	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.
Have there been any instances of non-compliance or suspected non-compliance with law and regulation since 1 April 2015, or earlier with an on-going impact on the 2015/16 financial statements?	None known

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# Impact of laws and regulations

Question	Management response
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.
Is there any actual or potential litigation or claims that would affect the financial statements?	None other than disclosed in the list of contingent liabilities within the Annual Statement of Accounts.
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	None that we are aware of.

# 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.

The code of practice on local authority accounting requires an authority's financial statements to be prepared on a going concern basis. Although the Council is not subject to the same future trading uncertainties as private sector entities, consideration of the key features of the going concern provides an indication of the Council's financial resilience.

As auditor, we are responsible for considering the appropriateness of use of the going concern assumption in preparing the financial statements and to consider whether there are material uncertainties about the Council's ability to continue as a going concern that need to be disclosed in the financial statements. We discuss the going concern assumption with management and review the Council's financial and operating performance.

Going concern considerations have been set out below and management has provided its response.

# Going concern considerations

Question	Management response
Does the Council have procedures in place to assess the Council's ability to continue as a going concern?	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.
Is management aware of the existence of other events or conditions that may cast doubt on the Council's ability to continue as a going concern?	None that we are aware of.
Are arrangements in place to report the going concern assessment to the Audit & Risk Committee?	Indirectly through the statement of accounts.
Are the financial assumptions (eg future levels of income and expenditure) consistent with the Council's Business Plan and the financial information provided to the Council throughout the year?	This may require some discussion to fully understand, it is however possible to confirm that the Council (generally) has a good track record of outturning within budget each year.

# Going concern considerations

Question	Management response
Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	Yes, these are fully reflected in the MTFS as budget pressures.
Have there been any significant issues raised with the Audit & 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).	None that we are aware of.
Does a review of available financial information identify any adverse financial indicators including negative cash flow? If so, what action is being taken to improve financial performance?	No adverse financial indicators are currently being reported.
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?	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.

# Related parties

## Issue

### Matters in relation to related parties

For local government bodies the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) requires compliance with IAS24: related party disclosures. The Code identifies the following as related parties:

- Subsidiaries;
- Associates;
- Joint ventures
- An entity that has an interest in the authority that gives it significant influence;
- Key management personnel and close family members; and
- Pension fund for the benefit of employees

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. I will also carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate.



# Related parties assessment

Question	Management response
Who are the Council's related parties?	<p>The Council has a number of related parties which are disclosed in the financial statements.</p> <p>The Council owns two other organisations YOO Recruit Ltd &amp; Wolverhampton Homes Ltd.</p> <p>In addition members 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>A digitalised system for officers to disclose personal interests (of themselves, their spouses, partners &amp; significant others) to the Monitoring Officer is being rolled out to replace paper disclosure.</p>

# Accounting estimates

## Issue

### Matters in relation to Accounting Estimates

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.

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 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.

# Estimates considerations

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- valued as part of a 5 year rolling programme at fair value or depreciated replacement cost. For 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

# Estimates considerations

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
Provision for irrecoverable debts	Provision is based on the age of the debt and assessment of collectability.	Reasonableness check by finance staff based on past history and experience.	No	Collection rates, historically, been relatively constant and level of bad debt write-offs in prior years indicate that the provision is adequate.	No

# Appendix 1: 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?
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.
Accumulated absence account	Accrual is based on outstanding leave as at 31 March 2016 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



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