

# Informing the audit risk assessment for Leicester City Council

**Year Ended 31 March 2019**

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# Purpose

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The purpose of this report is to contribute towards the effective two-way communication between those charged with governance for Leicester City 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.

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# Fraud

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## 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>Through independent challenge of the figures within the accounts and gaining assurance over controls from internal audit.</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>The Council has a counter fraud team who are responsible for investigating instances of fraud.</p> <p>The team report to Audit &amp; Risk Committee periodically, to provide an update on any instances of fraud and actions taken.</p>
<p>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> </ul> <p>Are there particular locations within the Council where fraud is more likely to occur?</p>	<p>The Council is at particular risk of fraud in the usual higher risk areas e.g repairs and maintenance, procurement and contract management. The Council has the relevant controls in place to try and prevent fraud. This is further supported by the reports of internal audit.</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"><li>• the process for reviewing the system of internal control;</li><li>• internal controls, including segregation of duties; exist and work effectively?</li></ul> <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>The Council has a clear governance framework summarised below;</p> <ul style="list-style-type: none"><li>• Mayor, Executive &amp; Council</li><li>• Decision Making</li><li>• Risk Management</li><li>• Scrutiny &amp; Review</li><li>• Corporate Management Team</li></ul> <p>Further to the Council has various codes and rules, including Financial Procedure Rules, Codes of Conducts, Anti-Fraud, Bribery &amp; Corruption Policy.</p> <p>Further to this the Council participates in the National Fraud Initiative.</p> <p>The Council outsources it's internal audit function to Leicestershire County Council to ensure regular review of it's control environment. The outcomes of audit reports are regularly reported, to Senior management and the Audit &amp; Risk Committee.</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 uses various options to communicate with employees including;</p> <ul style="list-style-type: none"><li>• Staff intranet, established internal communication channels</li><li>• Organisational development team, delivering staff training</li><li>• Information assurance team to support data policies</li></ul> <p>The Council encourages staff to report their concerns regarding fraud through the following policies;</p> <ul style="list-style-type: none"><li>• Anti-fraud, Bribery &amp; Corruption Policy</li><li>• Whistleblowing Policy</li></ul>

# Fraud risk assessment (continued)

Question	Management response
<p>From a fraud and corruption perspective, what are considered to be high-risk posts?</p> <p>How are the risks relating to these posts identified, assessed and managed?</p>	<p>Director of Finance Treasury Manager Risks associated by the above posts are managed through having appropriate controls in place.</p> <p>LCC undertake ID checks on applicants and also fully participate in the NFI project. This provides further assurance as this allows the payroll file to be cross matched against the directorships of companies with whom the council do business.</p> <p>Work is ongoing to centralise the conflict of interest file and this will be checked against all new procurement exercises.</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>The Council is unaware of any related party relationships that could give rise to instances of fraud. The Council maintains information on any related parties to ensure any risks can be mitigated and appropriate controls are in place.</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>Two reports are submitted to the Audit &amp; Risk Committee annually to report on fraud issues. Along with this internal audit also report to committee on outcomes from internal audits.</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?	No

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# Laws and regulations

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## 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>The Council employ legal professionals to ensure it remains compliant with all relevant laws and regulations.</p> <p>Legal implications are included on all decision-making reports, scrutiny reports and a number of internal briefing reports. On a case-by-case basis lawyers are embedded into the operational decision-making structures within client areas (child protection, adults safeguarding, HR etc)</p> <p>A Quarterly Governance Panel comprising the Chief Operating Officer and the two Statutory Officers has been set up to provide an additional layer of scrutiny to what are regarded as the Council's high-risk activities/schemes.</p>
<p>How is the Audit and Risk Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>Legal implications are included on all reports taken to Committee, including 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>There have been no known instances of significant non-compliance with law and regulation.</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?	No
What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?	All legal work is undertaken on a single specialist case management software system. In individual client areas (e.g. debt recovery, care proceedings, employment law etc) regular client liaison meetings occur or data is shared. Elevation mechanisms within Legal ensure that high-profile cases are referenced with senior management. Our insurance arrangements are closely managed to ensure that insurable claims are efficiently handled. All Judicial Review claims are brought to the attention of the City Barrister.
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	No

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# Going Concern

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## **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
Has a report been received from management forming a view on going concern?	The Council does not formally complete a report on Going Concern. However the Council completes an Annual Budget report each year that goes to the Overview Select Committee (and other scrutiny committees) for scrutiny and then to Full Council for approval. This includes medium term forecasts and risks to those forecasts, as well as future action required to remain a going concern.
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?	The financial assumptions in the budget report are consistent with the financial information reported throughout the year. Nonetheless, the information also has to respond to changes (e.g. the recent business rates pilot announcement).
Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	Any changes in statutory or policy changes with a financial impact are reflected and reported in the financial forecasts of the Council.
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).	No

# 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. Cash balances are buoyant.</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>Yes</p>
<p>Does the Council have procedures in place to assess the Council ability to continue as a going concern?</p>	<p>The Council annually completes the Budget Setting process, and through this a forecast is done of the financial position. In the report assumptions and areas of risk are highlighted. The financial position is routinely monitored during the year, as is income collection.</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>Like all authorities, the Council has been severely affected by funding cuts. We have always managed to balance budgets, avoiding crisis cuts, and 19/20 is no exception. The medium term looks difficult, but we have a track record of managing cuts if more are required.</p>
<p>Are arrangements in place to report the going concern assessment to the Audit and Risk Committee?</p>	<p>A Going Concern is not formally reported to Committee. But all elected members are on Full Council and vote on the budget report which highlight the Councils financial position.</p>

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# Related Parties

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## 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?	Currently no further related parties have been identified from the 2017/18 accounts. The full process to review will happen during February and March.
What are the controls in place to identify, account for, and disclose, related party transactions and relationships?	Members & Directors are asked to complete an annual declaration. The Council also takes part in the National Fraud Initiative.

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# Accounting estimates

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## 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?	Yes
Are the management arrangements for the accounting estimates, as detailed in Appendix A, reasonable?	Yes
How is the Audit and Risk Committee provided with assurance that the arrangements for accounting estimates are adequate?	The material estimates are reported in the Statement of Accounts. Further to this briefing & training sessions are completed with the Audit & Risk Committee to ensure they understand the arrangements used for completion including estimates. The Committee is encouraged to ask questions to gain assurance that officers are able to provide robust answers.

# 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?
Depreciation of PPE	<p>Assets are depreciated over their useful lives, with remaining useful life being updated as and when assets are revalued.</p> <p>A spreadsheet based asset register is maintained that holds all variables required for depreciation calculation on an asset-by-asset basis.</p> <p>All depreciable assets are depreciated on a straight line basis.</p>	Any changes in useful lives are reviewed by Finance to ensure any material movements are understood.	RICS valuers are appointed to undertake the annual valuations and update their useful life.	<p>It is assumed that the remaining useful life of assets reflect the level of repairs and maintenance that will be made.</p> <p>All depreciable assets are depreciated assuming no residual value.</p>	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?
Revaluation & Impairment of PPE	<p>Non-dwelling property valuations are planned at the beginning of each financial year by Estates &amp; Building Services. The Valuer is asked to provide estimated property values as at the end of the financial year using forecast valuation indices.</p> <p>Programme of planned valuations maintained by Estates &amp; Building Services to ensure that all land and buildings are regularly revalued.</p> <p>Forward indices published by the Building Cost Information Service are used to forecast property values at the Balance Sheet date.</p>	The Valuer reviews valuations at the Balance Sheet date to ascertain appropriateness of estimated valuations and therefore any material under- or over-statement.	RICS valuers are appointed to undertake the annual valuations.	Actual indices will not vary greatly from forecast indices.	Yes, the revaluation date of non-dwellings and properties has been moved from the 1 <sup>st</sup> April to 31 <sup>st</sup> March.
Bad Debt Provision	<p>A bad debt provision is calculated based on the age &amp; total of outstanding debt at the balance sheet date.</p> <p>Standard percentages and knowledge of individual circumstances are used.</p>	Reviewed to ensure significant movements are understood and are prudent.	No	No policy or legal change affects the collection of this debt.	No but this is currently being reviewed to ensure it is in line with IFRS9

# 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?
Insurance Claims	This is estimated based on the claims received and which are expected to be settled.	Insurance company's, claims database is used, providing the estimate. Actuaries have been used during 2018 to review the reasonableness of the estimates.	Insurance Company & Actuaries	The status of the Claim has been maintained.	No
Business Rates	Business Rates appeals- Judgement is applied based on data from the Valuation Office Agency regarding outstanding appeals and the likelihood of success. The amount of the reduction and the backdating of the appeal have been based upon averages of historic settled appeals data and any other known information	Different averages are calculated for the different types of appeals and property types.	Revenues Manager	The calculation is based on a range of sources including professional advice. If the volume and outcome of appeals differs significantly from the assumptions then this will impact on the level of provision	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?
Liabilities under PFI Schemes	<p>Total payments due under existing PFI schemes are split between payments for services, reimbursement of capital expenditure, interest and lifecycle costs. The split being derived from detailed cash flow models provided at the commencement of each scheme. PFI liabilities are reduced by payments made during the year.</p> <p>Financial model detailing cash flows of schemes provided by KPMG.</p>	Changes to outstanding liabilities are measured against the financial model and split between current and non-current accordingly.	No	<p>It is assumed that the PFI schemes will progress as planned with specifications remaining unchanged.</p> <p>PFI unitary payments are being made as per the financial model.</p>	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?
Pension Liability	Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets.	Checks to the reasonableness of assumptions in the actuaries report are made	Yes (actuary for LGPS administered by Leicestershire County Council)	The effects of the net pension liability of changes in individual assumptions can change the liability significantly. Eg an 0.5% decrease in the Real Discount rate would mean a 10% increase to the employers liability of approximately £200m	

