

Informing the audit risk assessment for Newcastle-under-Lyme Borough Council

Year ended

31 March 2019

Phil Jones

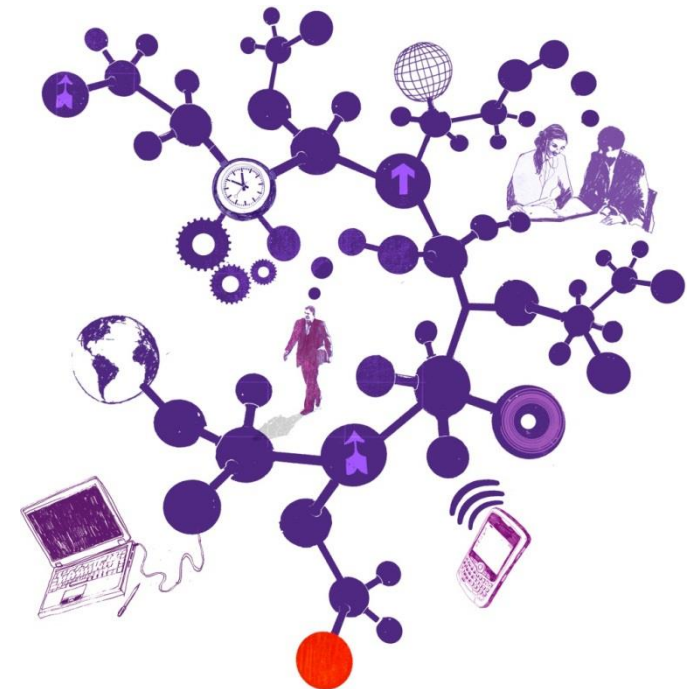
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Purpose

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

This two-way communication assists both the auditor and the Audit 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 Committee and supports the Audit 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 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 responses we have received from the Council's management. The Audit Committee should consider whether these responses are consistent with 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 Committee and management.

Management, with the oversight of the Audit 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 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 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 Committee oversees the above processes. We are also required to make inquiries of both management and the Audit 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? What are the results of this process?</p>	<p>Yes. Risk assessments are in place.</p>
<p>What processes does the Council have in place to identify and respond to risks of fraud</p>	<p>There is a Fraud Awareness guide for which requires managers to complete an assessment for their service area – these are then taken into consideration when formulating the audit plan.</p>
<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>No specific high risks have been identified. Cyber Security Risks have been identified, mandatory Information Security briefing sessions will be presented to all staff in 2019/20 which will cover the issue of Cyber Security to raise awareness amongst staff. Phishing emails are forwarded to Action Fraud and Sophos</p>
<p>Are internal controls, including segregation of duties, in place and operating effectively? If not, where are the risk areas and what mitigating actions have been taken?</p>	<p>All internal controls and segregation of duties are in place and operating effectively.</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>No areas have been identified where there is a potential override of controls or inappropriate influence over the financial reporting process.</p>
<p>How does the Audit Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control? What arrangements are in place to report fraud issues and risks to the Audit Committee?</p>	<p>Quarterly reports are presented to the Audit and Risk Committee in relation to outstanding high risk recommendations and progress against the Audit Plan. These reports provide details of issues identified as part of the audits. Fraud issues and risks are also reported to the committee, the Fraud policies are presented annually to the committee for review.</p>

Fraud risk assessment (continued)

Question	Management response
How does the Council communicate and encourage appropriate business practice and ethical behaviour of its employees and contractors?	CIPFA's Whistleblowing e-learning package has been delivered to all staff. In addition CIPFA's Bribery & Corruption package has been purchased and will be rolled out during 2019/20. Reminders are also issued through monthly Core Briefs
How do you encourage employees to report their concerns about fraud? Have any significant issues been reported?	A whistleblowing policy is in place, we also subscribe to Public Concern at Work and have posters displayed around our buildings to raise awareness.
Are you aware of any related party relationships or transactions that could give rise to risks of fraud?	We are not aware of any related party relationships or transactions that could give rise to instances of fraud. Board members are required to declare relevant interests at Board and Audit Committee meetings.
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 2018? If so how does the Audit Committee respond to these	No
Are you aware of any whistleblower reports or reports under the Bribery Act since 1 April 2018? If so how does the Audit Committee respond to these	No

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 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 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?	<p>A range of policies exist which include the Code of Corporate Governance, Employee Code of Conduct, Anti Fraud & Corruption, Anti Money Laundering , Whistle Blowing. Also Registers of Outside Interests, Gifts & Hospitality.</p> <p>In addition the Council's Constitution incorporates Contract Procedures and Financial Regulations together with a Members Code of Conduct.</p> <p>We have risk registers in place for both operational and health and safety risk.</p>
How does management gain assurance that all relevant laws and regulations have been complied with?	<p>Risk based audit plan</p> <p>Corporate Governance Working Group</p> <p>Annual Assurance Statements completed by Heads of Service and Executive Directors</p> <p>Statutory Officers Group – bi monthly meeting of the CEO, Section 151 Officer and Monitoring Officer</p>
How is the Audit Committee provided with assurance that all relevant laws and regulations have been complied with?	Regular audit reports
Have there been any instances of non-compliance or suspected non-compliance with law and regulation since 1 April 2018 with an on-going impact on the 2018/19 financial statements?	No
What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?	Statutory Officers Group – bi monthly meeting of the CEO, Section 151 Officer amd Monitoring Officer.
Are there any actual or potential litigation or claims that would affect the 2018/19 financial statements?	No
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	HMRC carried out an audit of payments to individuals, the final report has still not yet been received. (January 2015)

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 for the Council. The accounting concept of going concern refers to the basis of measurement of an organisation's assets and liabilities in its accounts (that is the basis on which those assets and liabilities are recorded and included in the accounts)

Entities are viewed as continuing in business for the foreseeable future. Assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business. If the entity could not continue as a going concern, assets and liabilities would need to be recorded in the accounts on a different basis, reflecting their value on the winding up of the entity. Consequently, assets would be likely to be recorded at a much lower break-up value and medium – and long- term liabilities would become short-term liabilities.

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

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?	Yes.
Is management aware of the existence of events or conditions that may cast doubt on the Council's ability to continue as a going concern?	No
Are arrangements in place to report the going concern assessment to the Audit Committee?	No
Are the financial assumptions in that report (e.g. future levels of income and expenditure) consistent with the Council's Business Plan and the financial information provided to the Council throughout the year?	Not applicable

Going Concern Considerations (continued)

Question	Management response
Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts?	Yes.
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).	No.
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?	Yes. Potential revenue budget overspend. Action plan in place to deal with this.
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?	Yes

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. This 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 identified the transactions, events and conditions that may give rise to the need to 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
- Estimates have been calculated consistently with other accounting estimates within the financial statements.

Accounting Estimates

Question	Management response
Are the 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 judgment?	Yes
Are the management arrangements for the accounting estimates as detailed in Appendix 1 reasonable?	Yes
How is the Audit Committee provided with assurance that the arrangements for accounting estimates are adequate?	Via statement of accounts

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 IAS 24:Related Party disclosures. The Code identified the following as related parties to local government bodies:

- Entities that directly, or indirectly through one or more intermediaries, control or are controlled by the authority (i.e. subsidiaries)
- Associates
- Joint Ventures in which the authority is a venturer
- An entity that has an interest in the authority that gives it significant influence over the authority
- Key management personnel, and close members of the family of key management personnel
- Post-employment benefit plan (Pension fund) for the benefit of employees of the authority, or of any entity that is a related party of the authority.

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

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

Question	Management response
What controls does the Council have in place to identify, account for and disclose related party transactions and relationships?	<p>Monitoring of a Register of Interests for Members, a register for pecuniary interests in contracts for Officers and Senior Managers requiring disclosure of related party transactions.</p> <ul style="list-style-type: none">• Annual return of any known related party interests completed by members and senior officers• Review if in-year income and expenditure transactions with known identified related parties from prior year of known history.• Review of the accounts payable and receivable systems and identification of amounts paid to/from assisted or voluntary organisations.

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?
Property, plant and equipment valuations	Valuations are made by senior valuation staff (RICS Members) inline with RICS guidance on the basis of 5 year valuations with interim reviews	Capital Accountant notifies the valuer of the program of rolling valuations or of any conditions that warrant an interim re-valuation	In-house valuer RICS Member	Valuations are made in-line with RICS guidance – reliance on expert	Changed valuation basis for non-charging car parks and community centres let to management organisations from DRC to Investment.
Estimated remaining useful lives of PPE	Other land & buildings – 60 years, unless the valuation basis is depreciated replacement cost, where individual lives apply to each asset concerned. Vehicles, Plant, Furniture & Equipment – 5 years for most items, 15 years to wheeled bins Infrastructure – no specific life. Depreciation is based on historical composite calculation Community Assets – 20 years	Consistent asset lives applied to each asset category	In-house valuer RICS Member	This life would be recorded in accordance with the qualified RICS Member’s valuation and this would be cross checked to ensure this accords with the accounting policy for the Council	No

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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?
Depreciation and amortisation	<p>The following asset categories have general asset lives: Dwellings and other buildings – straight line allocation over the useful life of the property as estimated by the valuer.</p> <p>Vehicles, Plant and Equipment – straight line allocation over estimated life of asset.</p> <p>Infrastructure Assets – straight line allocation over estimated life of asset.</p>	Charged in the year that the Council becomes aware of the obligation	No	<p>The length of the life is determined at the point of acquisition or revaluation according to:</p> <p>Assets acquired in the financial year are not depreciated until the following financial year.</p> <p>Assets that are not fully constructed are not depreciated until they are brought into use.</p>	No
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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?
Impairments	Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired. Where indications exist and any possible differences are estimated to be material, the recoverable amount of the asset is estimated and, where this is less than the carrying amount of the asset, an impairment loss is recognised for the shortfall.	Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired	Use the in-house valuers, RICS Members	Valuations are made in line with RICS guidance – reliance on experts	No

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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?
<p>Non adjusting events – events after the BS date</p>	<p>S151 Officer makes the assessment. If the event is indicative of conditions that arose after the balance sheet date then this is an un-adjusting event.</p> <p>For these events only a note to the accounts is included, identifying the nature of the event and where possible estimates of the financial effect.</p>	<p>Heads of Service notify the S151 Officer</p>	<p>This would be considered in individual circumstances</p>	<p>This would be considered in individual circumstances</p>	<p>No</p>
<p>Overhead allocation</p>	<p>The total absorption costing principal is used – full cost of overheads and support services are shared between users in proportion to the benefits received. With the exception of Corporate and Democratic Core and Non-Distributed Costs</p>	<p>All support service cost centres are allocated according to agreed allocations</p>	<p>No</p>	<p>Apportionment bases are reviewed each year to ensure equitable.</p>	<p>No</p>

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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?
Measurement of Financial Instruments	Council Values financial instruments at fair value based on the advice of their external treasury consultants and other financial professionals	Take advice from finance professionals	Yes	Take advice from finance professionals	No
Bad debt provision	A provision is estimated using a proportion basis of an aged debt listing	Revenues provide the aged debt listing and Finance calculate the provision	No	Consistent proportion used across aged debt as per the SORP	No

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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 that gives the Council a legal or constructive obligation that probably requires settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation. Provisions are charged as an expense to the appropriate service line in the CI&ES in the year that the Council becomes aware of the obligation, and are measured at the best estimate at the balance sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties.	Charged in the year that the Council becomes aware of the obligation	No Reference is made to the Insurance Brokers Report for Insurance Provision.	Estimated settlements are reviewed at the end of each financial year – where it becomes less than probable that a transfer of economic benefits will now be required (or a lower settlement than anticipated is made), the provision is reversed and credited back to the relevant service. Where some or all of the payment required to settle a provision is expected to be recovered from another party (e.g. from an insurance claim), this is only recognised as income for the relevant service if it is virtually certain that reimbursement will be received by the Council.	No
Accruals	Finance collate accruals of expenditure and income. Activity is accounted for in the financial year that it takes place, not when money is paid or received.	Activity is accounted for in the financial year that it takes place, not when money is paid or received.	No	Accruals for income and expenditure have been principally based on known values. Where accruals have had to be estimated the latest information has been used.	No

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