Informing the audit risk assessment West Midlands Fire & Rescue Authority 2018/19

Year ended 31 March 2019

Richard Percival
Engagement Lead
T 0121 232 5434
E richard.d.percival@uk.gt.com

Javed Akhtar
Manager
T 0121 232 5340
E javed.akhtar@uk.gt.com

Steph Quartermaine
Audit Executive
T 0121 232 5238
E steph.quartermaine@uk.gt.com

Agenda

Purpose	3
Fraud	4
Fraud risk assessment	5-8
Laws and regulations	9
Impact of laws and regulations	10-12
Going concern	13
Going concern considerations	14-15
Related parties	16-17
Accounting estimates	18-19
Appendix A – Accounting estimates	20-23

Purpose

The purpose of this report is to contribute towards the effective two-way communication between auditors and the Authority's Audit and 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 and 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 and Risk Committee. ISA(UK&I) emphasise the importance of two-way communication between the auditor and the Audit and Risk Committee 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 Audit and Risk Committee 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 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 Authority's management. The Audit and Risk Committee should consider whether these responses are consistent with the 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 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 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 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 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 Authority's management.

Fraud risk assessment

Question	Management response
Has the Authority assessed the risk of material misstatement in the financial statements due to fraud, including the nature, extent and frequency of such assessments?	Although there is an on-going risk of fraud being committed against the Authority, arrangements are in place to both prevent and detect fraud. These include work carried out by Internal Audit on overall fraud risk areas. However, the risk of material misstatement of the accounts due to undetected fraud is considered to be low.
What processes does the Authority have in place to identify and respond to risks of fraud, including any identified specific risks of fraud and risks of fraud likely to exist?	The Authority has a Anti Fraud & Corruption standing order in place. This is also supported by a Whistleblowing Policy which includes a confidential reporting framework; these are reviewed in a timely manner. Internal Audit include fraud risks in their planning process and act as an effective internal control against fraud. Regular reports are made to Audit and Risk Committee. In addition, the Authority receives advice from the Audit Fraud Team at Sandwell Metropolitan Borough Council.
Have any specific fraud risks, or areas with a high risk of fraud, been identified and what has been done to mitigate these risks?	Evidence published by the National Fraud Authority amongst others, suggests that fraud is committed in all organisations to varying degrees, so it is likely that some fraud is occurring at West Midlands Fire & Rescue Authority. The Authority also participate in the National Fraud Initiative. The Internal Audit plan incorporates consideration of potential fraud. In addition to this management is expected to identify and record fraud risks where necessary on the corporate risk register. No instances of fraud have been detected in 2018/19.
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?	Yes – there is an adequate process in place for reviewing the system of internal control via the work of Internal Audit. Internal Audit include fraud risks in their planning process and act as an effective internal control against fraud.
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)?	None known. Head of Internal Audit Opinion in 2017/18 did not highlight any weaknesses in this area.

Fraud risk assessment

Question	Management response
Are there any areas where there is a potential for misreporting override of controls or inappropriate influence over the financial reporting process?	None known. Head of Internal Audit Opinion in 2017/18 did not highlight any weaknesses in this area.
How does the Authority communicate with those charged with governance regarding their processes for identifying and responding to risks of fraud in the entity?	Internal Audit provide the Audit & Risk Committee with updates of their work on fraud prevention and detection, including any significant identified frauds and the action taken. The Audit Fraud team at Sandwell Metropolitan Borough Council also provide training to the Authority.
How does the Authority communicate ethical behaviour of its staff and contractors?	There is an Employee Code of Conduct and Financial Regulations. Staff are regularly reminded of these.
How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?	There is a Anti Fraud & Corruption standing order in place and a Whistleblowing procedure in place which explain the procedures to follow. No significant issues have been reported under the Bribery Act.
Are you aware of any related party relationships or transactions that could give rise to risks of fraud?	The 2017/18 financial statement disclosure of related party transactions does not identify potential fraud risk. Members and officers are required to make full disclosure of any relationships that impact on their roles. Members are required to declare any relevant interests at Authority and Committee meetings.
Are you aware of any instances of actual, suspected, or alleged fraud either within the Authority as a whole or within specific departments since 1 April 2018?	There are no known instances of fraud that have been identified during the year.
Are you aware of any whistle-blower reports or reports under the Bribery Act since 1 April 2018? If so, how does the Audit and Risk Committee respond to these?	There are no known instances that have been identified during the year.

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 Audit and Risk Committee, is responsible for ensuring that the Authority'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 and 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 noncompliance and the possible effect on the financial statements.

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

Grant Thornton | An instinct for growth™

Impact of laws and regulations

Question	Management response
What arrangements does the Authority have in place to prevent and detect non-compliance with laws and regulations?	The Monitoring Officer is responsible for ensuring the Authority is compliant with laws and regulations. These responsibilities cover: •complying with the law of the land (including any relevant Codes of Conduct); •complying with any General Guidance issued, from time to time, by the Standards Committee and / or advice of the Monitoring Officer; •making lawful and proportionate decisions; and •generally, not taking action that would bring the Authority, their offices or professions into disrepute. This officer has access to all Authority Committee reports. The Monitoring Officer raises awareness on legal requirements at meeting where needed. In addition in terms of any specific legal issues the Monitoring Officer would get involved at an early stage. Further information on how the Monitoring Officer carries out these responsibilities are detailed in the Constitution. The Strategic Enabler of Finance & Resources, the Authority's s151 officer is responsible for preparing the accounting statements in accordance with relevant legal and regulatory requirements. The Senior Financial Accountant also attends the West Midlands Support Group for Financial Matters to exchange information, share best practice and discuss the implementation of relevant changes. This is supplemented by the annual technical accounting workshops run by CIPFA and also by Grant Thornton.
How does management gain assurance that all relevant laws and regulations have been complied with?	See response above
How is the Audit and Risk Committee provided with assurance that all relevant laws and regulations have been complied with?	See response above
Have there been any instances of non-compliance or suspected non-compliance with law and regulations since 1 April 2018, or earlier with an on-going impact on the 2018/19 financial statements?	None noted.

Impact of laws and regulations

Question	Management response
What arrangements does the Authority have in place to identify, evaluate and account for litigation or claims?	The Strategic Enabler of Finance & Resources is advised of any outstanding litigation claims that would have a material impact on the accounts.
Is there any actual or potential litigation or claims that would affect the financial statements?	None noted.
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate noncompliance?	None noted.

Going concern

Matters in relation to laws and regulations

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.

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

We have discussed the going concern assumption with key Authority officers and reviewed the Authority's financial and operating performance. Below are key questions on the going concern assumption which we would like the Audit and Risk Committee to consider.

Going concern considerations

Question	Management response
Is the going concern basis of accounting a fundamental principle in the preparation of the financial statements ?	The Authority's latest Medium Term Financial Strategy indicates a balanced position in year with a Financial Efficiency Plan to meet the reduction in core funding from 2016/17 – 2019/20. However, saving required within the Financial Efficiency Plan would not be fully achieved and therefore a Strategy Options report was submitted to Members for approval (18/02/19). The budget report also highlighted a number of issues which could influence future core funding, which the Authority would need to consider and monitor progress. The Authority has appropriate levels of reserves to support these deficits in the short term. This strategy, as well as the in year budget (2017/18) reflects government changes in terms of core funding and the financial settlement. The 2019/20 budget was approved by the Authority on 18/02/2019.
Has a preliminary assessment of the entity's ability to continue as a going concern been performed ?	See response above.
What is the basis for the intended use of the going concern assumption, and are management aware of the existence of other events or conditions that may cast doubt on the Authority's ability to continue as a going concern ?	The Authority has developed and approved a 2019/20 Budget and a Medium Term Financial Strategy which set out the financial challenges facing the Authority in the short to medium term and the action necessary to ensure that the Authority is able to continue to maintain a sustainable financial position.
Are arrangements in place to report the going concern assessment to the Audit and Risk Committee?	The Strategic Enabler of Finance and Resources has presented details of the 2019/20 budget and underlying assumptions to Members. No significant issues were raised which cast doubt on the assumptions made. Members recognise that the Authority is facing a challenging financial position in the medium term, however in the short term the efficiency plan proposals and level of accumulated reserves are sufficient to ensure the delivery of priorities.
Are the financial assumptions in that report (e.g., future levels of income and expenditure) consistent with the Authority's Business Plan and the financial information provided to the Authority throughout the year?	The Medium Term Financial Strategy sets out detailed assumptions and makes clear reference to the Authority Plan as the basis for the financial considerations in setting the medium term budget. The Financial Efficiency Plan has been prepared by appropriately qualified and experienced staff in consultation with Service Managers. The financial assumptions are therefore consistent with the Authority Plan.

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?	The Authority's latest Medium Term Financial Strategy and 2019/20 Budget reflect government changes in terms of the indicated reduction in core funding and the financial settlement.
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).	The Strategic Enabler of Finance and Resources presented details of the 2019/20 budget on 18/02/2019. No significant issues were raised which cast doubt on the assumptions made. Members recognise that the Authority is facing a challenging financial position in the medium term, however in the short term the efficiency plan proposals and level of accumulated reserves are sufficient to ensure delivery of priorities.
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?	Review of the latest detailed financial information presented to Authority members (as at January 2019) did not highlight any adverse financial indicators which required specific action. A Treasury Management Strategy is approved by the Authority as part of the budget setting report.
Does the Authority have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Authority's objectives? If not, what action is being taken to obtain those skills?	It is considered that the Authority has the appropriate skills and expertise within its Senior Management Team to enable it to address the financial challenges faced in the medium term. Succession planning is in place for any changes planned for 2019/20.

Related parties

Matters in relation to Related Parties

Local Authorities are required to comply with International Accounting Standard 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 Authority (i.e. subsidiaries);
- associates and/or joint ventures;
- 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, and
- post-employment benefit plans (pension fund) for the benefit of employees of the Authority, or of any entity that is a related party of the Authority.

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 Authority's perspective but material from a related party viewpoint then the Authority 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 party considerations have been set out below and management has provided its response.

Related parties

Question	Management response
What controls does the Authority have in place to identify, account for, and disclose related party transactions and relationships?	A number of arrangements are in place for identifying the nature of a related party and reported value including: • Maintenance 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. • Annual return from senior managers/officers requiring confirmation that they have read and understood the declaration requirements and stating details of any known related party interests. • Annual return from Members stating details of any known related party interests. • Review of in-year income and expenditure transactions with known identified related parties from prior year or known history. • Review of related information with subsidiaries, companies and joint ventures, e.g. accounts. • Review of the accounts payable system and identification of amounts paid to assisted or voluntary organisations.
Who are the Authority's related parties, including changes from prior period?	The Authority has a number of related parties in which there is a material impact to the financial statements via virtue of whether the Authority might have: • the potential either to be controlled or influenced by the party or • the potential to exert control or influence over the party (as defined by guidance in the Code). The Authority discloses its related parties under the following headings: 1.Central Government (Non Domestic Rates income) – central government has control influence over the Authority as the Authority needs to act in accordance with its statutory responsibilities. 2.West Midland Local Authorities (Council Tax income) – these parties are subject to common control by central government and thus might be empowered to transact on non-commercial terms. There are processes in place to identify related party transactions with Members and Officers – Certain Members and Officers may have controlling influence or related interests with other of the Authority's related party organisations, such that they may be in a position to significantly influence the policies of the Authority. In 2017/18 there were no such related parties identified. Going forward the Authority will have closer dealings with West Midlands Combined Authority in the continued move to be part of the WMCA, however this will not include any financial transaction to be reported in the financial statements note.

Accounting estimates

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 Authority 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 Authority are using as part of their accounts preparation: these are detailed in appendix 1 to this report.

The audit procedures we conduct on the accounting estimate will demonstrate that:

• the estimate is reasonable; and

• estimates have been calculated consistently with other accounting estimates within the financial statements.

Accounting estimates

Question	Management response
Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable?	Yes, where estimates are required appropriate estimation methodology is utilised. Estimated are prepared by those who are best qualified e.g. for pension and asset valuations.
How are transactions, events, and conditions identified that may give rise to the need for accounting estimates to be recognised or disclosed in the financial statements?	The Statement of Accounts is prepared in accordance with the Code of Practice on Local Authority Accounting in the UK (Code), supported by International Financial Reporting Standards (IFRS) and statutory guidance.
Are there any changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates?	There are no major changes in circumstances for accounting estimates in 2018/19. Any changes to the Code and IFRS are reflected within the Statement of Accounts.
How is the Audit and Risk Committee provided with assurance that the arrangements for accounting estimates are adequate?	Accounting polices provide details within the Authority's Statement of Accounts. The Treasurer provide assurance to the Audit and Risk Committee and signs the Statement of Accounts.

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	Valuations are made by the appointed Valuer (Wilkes, Head and Eve Chartered Surveyors and Town Planners) in line with RICS guidance on the basis of 5 year valuations with interim reviews. The Authority are having a full valuation in 2018/19 following the change in estimation technique for specialised assets which was introduced in 2012/13.	Members of the Finance Team notifies the Valuer of the program of rolling valuations or of any conditions that warrant an interim re-valuation.	Valuer used for PPE valuations.	Valuations are made inline with RICS guidance - reliance on expert.	No
Impairment of property plant and equipment	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.	Valuer used for PPE valuations.	Valuations are made inline with RICS guidance - reliance on expert.	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	The following asset categories have general asset lives: • Operational Vehicles - straight line over 10 years. • Ancillary Vehicles - straight line over 5 years. • Equipment - straight line over 5 years. Depreciation is provided for all fixed assets with a finite life on a straight line basis. Asset lives for buildings are obtained from the Valuer. Freehold land is not depreciated. No depreciation is accounted for in the year of acquisition but is accounted for in the year of disposal.	Consistent asset lives applied to each asset category.	Valuer used for PPE and estimated remaining useful life assessments.	The method makes some generalisations. For example, buildings tend to have a useful life of 50 years. Although in specific examples based upon a valuation review, a new building can have a life as short as 25 years or as long as 70 years depending on the construction materials used. This life would be recorded in accordance with the local qualified RICS or CIB Member.	No
Provision for irrecoverable debts	A provision is estimated using a proportion basis of an aged debt listing.	Members of the Finance Team calculate the provisions from the aged debt listing based upon prior experience.	No	A consistent proportion of the aged debt listing is applied after any specific debts have been provided for where circumstances of certainty are known. The proportion is based upon the type of debt and historic payment pattern.	No

Grant Thornton | An instinct for growth™

Appendix A - Accounting estimates

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether manageme nt 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 Authority 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 value. Provisions are charged as an expense to the appropriate service line in the CIES in the year that the Authority 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 Authority becomes aware of the obligation. A calculation is made by the Senior members of the finance team based upon information from third parties, e.g. insurers, solicitors.	No	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 Authority.	No
Measurement of Financial Instruments	The Authority values financial instruments at fair value based upon current conditions and Senior Finance team judgement.	An estimate is made by senior members of the finance team.	No	The Authority does not have many balances which are required to be disclosed as a financial instrument. Considered straight forward with a low degree of estimation required.	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?
Accruals	The Finance Team collate accruals of income and expenditure from sales ledger, purchase ledger and budget information. Activity is accounted for in the financial year that it takes place, not when the money is paid or received in line with the accounting policies.	Sales ledger, purchase ledger and management accounts information is assessed by the Finance Team.	No	Accruals for income and expenditure have been principally based on known values. Where estimates have to be made these are based upon the latest available information.	No
Finance leases	Fixed assets recognised under finance leases are accounted for using the policies applied generally to Property, Plant and Equipment, subject to depreciation being charged over the lease term if this is shorter than the asset's estimated useful life.	Finance review contracts and payments to ensure the lease is categorised correctly.	No	Accounting entries are based upon schedules setting out the costs over the life of the agreement, based upon the initial lease as a legally binding document. These are reviewed each year and applied over the life of the asset.	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?
Non adjusting events – events after the Balance Sheet date	The Strategic Enabler of Finance & Resources makes the assessment. If the event is indicative of conditions that arose after the balance sheet date then this is an un-adjusting event which is disclosed as a note to the accounts identifying the nature of the event and where possible estimates of the financial effect.	The Strategic Enabler of Finance & Resources liaises with the Finance Team and considers all known information.	No, unless the specific un-adjusting event requires additional expertise.	This would be considered individually for each case.	No
Pensions – defined benefit pension amounts and disclosures (LGPS, Uniformed Schemes 1992, 2006 & 2015)	The Authority is an admitted body to the Local Government Pension Scheme (LGPS). The Uniformed Schemes are unfunded and are administered by the Authority based upon guidance from MHCLG. Information is passed from the Authority to the Actuaries upon which they base their assessment for the estimate.	The Actuary reports are reviewed by Finance Staff for reasonableness.	Yes – the Actuary for the LGPS and the Uniformed Schemes.	Reliance upon another auditor – PwC for their work on the Actuary of the LGPS through their audit of the Wolverhampton City Council. Reliance upon the expertise of the Actuary of the Uniformed Pension Schemes.	No

Grant Thornton
An instinct for growth™

grantthornton.co.uk