Auditing Standards – Communication with the Audit Committee

West Midlands Fire and Rescue Authority

Audit year 31 March 2013

Contents

Introduction

The purpose of this report is to ensure there is effective two-way communication between the Fire Authority and the external auditor. The arrangements that we have agreed with the Authority are that we will discuss all relevant audit issues with the audit committee in the first instance. Key issues are then reported to full Fire Authority meeting in an appropriate format. This will usually be through the reporting of the minutes of the audit committee or taking full audit reports to the Fire Authority meeting, depending on their significance to the audit process.

As your external auditor, we have a responsibility under professional auditing standards to ensure there is effective communication with the Audit Committee. This means developing a good working relationship with Committee members, while maintaining our independence and objectivity. If this relationship works well it helps us obtain information relevant to our audit and helps Audit Committee members to fulfil their financial reporting responsibilities. The overall outcome helps to reduce the risk of material misstatement.

In planning and performing our audit of the financial statements we need to understand how the Audit Committee, supported by the Authority's officers, meets its responsibilities in the following areas.

- fraud
- laws and regulations
- going concern
- accounting for estimates
- related party transactions

This report summarises the respective responsibilities of the Audit Committee, officers and external audit in each of these areas, as set out by International Standards on Auditing (UK and Ireland) (ISAs). Our primary responsibility is to consider the risk of material misstatement.

Each section of the report includes a series of questions that officers have responded to. We would like to ask the Audit Committee to consider these responses and confirm that it is satisfied with the arrangements.

Fraud risk assessment

The International Standards on Auditing (ISAs) define fraud as:

"An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage."
[ISA (UK&I) 240, paragraph 11]

The primary responsibility to prevent and detect fraud is with the Audit Committee and individual officers. To do this:

- officers need to ensure there is a strong emphasis on fraud prevention and deterrence, with a commitment to honest and ethical behaviour
- Audit Committee oversight needs to include the potential for the override of controls and inappropriate influence over the financial reporting process.

Our overall responsibility is to ensure the Authority's financial statements are free from material misstatement due to either fraud or error. We are required to maintain professional scepticism throughout the audit, which means considering the potential for the intentional manipulation of the financial statements.

We are also required to carry out a fraud risk assessment to inform our audit approach. This includes considering the following:

- how management assesses the risk of material misstatement in the financial statements due to fraud;
- officers' response to assessed fraud risk, including any identified specific risks;
- investigations into data matches identified through the National Fraud Initiative and subsequent outcomes;
- how officers communicate the processes for assessing and responding to fraud risk to the Audit Committee;
- how officers communicate their views on ethical behaviour to the Audit Committee;
- how the Audit Committee exercises oversight of officers' fraud risk assessment and response processes and the internal controls to mitigate these risks; and
- what knowledge the Audit Committee has of actual, alleged or suspected fraud.

Table 1 below sets out how officers have responded to our fraud risk assessment.

Table 1: Fraud risk assessment

Question	Management response
1. What is officer's assessment of the risk of material misstatement in the financial statements due to fraud? Is this consistent with the feedback from your risk management processes?	Although there is a risk of fraud being committed, arrangements are in place to both prevent and detect fraud. These include work carried out by Internal Audit, which aims to raise awareness of fraud amongst staff and investigate specific incidents as required. The risk of material fraud is low due to: - the controls implemented over expenditure authorisation; and - most income received is predetermined receipt of grants and council tax.

2. Are you aware of any instances of fraud, either within the Authority as a whole or within specific departments since 1 April 2012?	Not aware of any fraud cases since 1 April 2012.
3. Do you suspect fraud may be occurring, either within the Authority or within specific departments? **• Have you identified any specific fraud risks?** **• Do you have any concerns there are areas that are at risk of fraud?** **Are there particular locations within the Authority where fraud is more likely to occur?**	Evidence published by the National Fraud Authority amongst others, suggests that fraud is committed in all organisations to varying degrees and WMFRA is no exception. However 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 areas have been identified where there is considered to be a risk of material fraud.
4. Are you satisfied that the overall control environment, including: **• the process for reviewing the system of internal control;** **• internal controls, including segregation of duties;** **exist and work effectively?** **If not where are the risk areas?** **What other controls are in place to help prevent, deter or detect fraud?**	Yes – the internal audit annual plan is developed based on a risk assessment and proactive work would be undertaken in key risk areas. In addition the Director of Resources takes note of other reporting from both internal and external audit and acts upon all recommendations made where there are implications for the wider control environment.

5. How do you communicate to employees about your views on business practices and ethical behaviour? **How do you encourage staff to report their concerns about fraud?** **• What concerns are staff expected to report about fraud?** **• Have any whistle-blower tips and complaints been received and what was management response and have been these been reported to the Authority?** **Has the Authority made any reports under the Bribery Act?**	Policies are in place such as code of conduct and whistleblowing, which are publicised on the intranet and in some cases with payslips as well to make all staff aware of them. Internal Audit also provide workshops to raise awareness. No concerns have been raised.
6. From a fraud and corruption perspective, what are considered to be high-risk posts? **How are the risks relating to these posts identified, assessed and managed?**	There are no significant high risk posts identified.
7. Are you aware of any related party relationships or transactions that could give rise to instances of fraud? **How do you mitigate the risks associated with fraud related to related party relationships and transactions?**	2011/12 financial statement disclosure of related party transactions does not identify potential fraud risk. All senior officers are required to make full disclosure of any relationships that impact on their roles. Members are required to declare any relevant interests at all committee meetings.

8. What arrangements are in place to report business risks and fraud issues to the Audit Committee?	Internal Audit alongside management are responsible for ensuring that all such risks are reported at Audit Committee. Internal Audit produce a progress report for each meeting which report all relevant significant issues.

Laws and regulations

Auditing standards require us to consider the impact that law, regulation and litigation may have on the Authority's financial statements. The factors that may result in particular risks of material misstatement due to fraud or error are:

- the operational regulatory framework - this covers the legislation that governs the operations of the Authority;
- the financial reporting framework - according to the requirements of the CIPFA/LASACC Code of Practice on Local Authority Accounting in the UK and International Financial Reporting Standards and relevant Directions;
- taxation considerations - for example compliance with Value Added Tax and Income Tax regulations;
- government policies that otherwise impact on the Authority's business;
- other external factors e.g. Mutual Municipal Scheme of Arrangements being triggered; and
- litigation and claims against the Authority.

Where we become aware of information about a possible instance of noncompliance we need to gain an understanding of it, to evaluate the possible effect on the financial statements.

The ISAs also require us to make enquiries of management and the Audit Committee about the arrangements in place to comply with law and regulation. To help with this, management have responded to the following questions.

Table 2: laws and regulations

Question	Management response
1. How does management gain assurance that all relevant laws and regulations have been complied with?	Individual Directors have responsibility for advising of any changes that require action at all relevant committee meetings. External legal advice is also considered when appropriate. All committee papers are required to include an assessment of potential legal implications.

2. How is the Audit Committee provided with assurance that all relevant laws and regulations have been complied with?	All committee papers are required to include an assessment of potential legal implications. The Section 151 officer (with assistance from the Director of Resources), is responsible for preparing the accounting statements in accordance with relevant legal and regulatory requirements and would update the full Fire Authority meeting regarding any significant issues.
3. Have there been any instances of noncompliance with law and regulation since 1 April 2012?	There are no instances of noncompliance with law and regulations.
4. Is there any actual or potential litigation or claims that would affect the financial statements?	There are no actual or potential litigation or claims which would affect the financial statements.

Going concern

Going concern is a fundamental principle in the preparation of financial statements. Under the going concern assumption, the 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 Committee to consider, along with the management responses provided.

Table 3 – Going concern

Question	Management response
1. Has a report been received from management forming a view on going concern?	The Director of Resources is satisfied that the budget proposals made are based on robust estimates. This was reported to the full Fire Authority meeting.
2. 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?	Yes – forecasts for 2012/13 and performance to date are considered and reviewed in detail and regular financial reporting is made to the Authority.
3. Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	Yes – it is the responsibility of all members of the finance team to ensure that all implications or policy changes are considered.

4. 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 issues have been raised either in 2012/13 or previously.
5. 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?	No negative indicators reported.
6. 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?	Yes adequate staff with relevant skills and experience are in post.

Accounting estimates

The Authority needs to apply appropriate estimates in the preparation of the financial statements. Accounting estimates are used when it is not possible to measure precisely a figure in the accounts. 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 Authority identifies the transactions, events and conditions that may give rise to the need for an accounting estimate.

We need to be aware of all estimates that the Authority is using as part of their accounts preparation; these are detailed at Appendix A, although audit processes concentrate on material estimates.

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

- the estimate is reasonable
- estimates have been calculated consistently with other accounting estimates within the financial statements.

Related Parties

For local government bodies, the Code of Practice on Local Authority Accounting in the United Kingdom requires compliance with IAS 24: Related party disclosures. The Code identifies 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, and
- 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. .

Table 4: Related Parties

Question	Management response
1. Who are the Authority's related parties?	The Authority discloses its related parties under the following headings: Government - central government has control influence over the Authority as the Authority needs to act in accordance with its statutory responsibilities. Precepts & Levies - these parties are subject to common control by central government and thus might be empowered to transact on non-commercial terms. The Authority is bound to pay the amount demanded from these parties through precept or levy. West Midlands Fire Service Business Safety Limited- a company wholly owned by the Authority 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.

2. What are the controls 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 read and understood the declaration requirements and 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 minutes of decision making meetings to identify any member declarations and therefore related parties.

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 valuations	Property valuations are made by the external valuer from the Valuation Agency (RICS Member) in line with RICS guidance on a rolling 5 year programme	The Finance Manager notifies the valuer of changes to the estate from the prior year	Use the External local RICS Member	Valuations are made in-line with RICS guidance - reliance on expert	No
Estimated remaining useful lives of PPE	Assets are assigned to asset categories with appropriate asset lives.	Consistent asset lives applied to each asset category.	For property use the External local RICS Member for valuations.	The useful lives of property are recorded in accordance with the local qualified RICS Member.	No

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	Depreciation is provided for on property plant and equipment with a finite useful life on a straight-line basis. No depreciation is accounted for in the year of acquisition but is accounted for in the year of disposal.	Consistent application of depreciation method across types of assets	No	The length of the life is determined at the point of acquisition or revaluation.	No
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 External local RICS Member for valuations.	Valuations are made in-line with RICS guidance - reliance on expert.	No

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?
Pensions- Defined benefit pension amounts and disclosures	The Authority administers three pension schemes – the 1992 and 2006 fire-fighters pensions scheme as well as the Local Government Pensions scheme	Rely on the calculations made by the actuary, based on information provided by the Authority. The Actuary's report is reviewed for reasonableness by senior staff.	Yes – Actuary for the pension schemes	Reliance on the expertise of the actuaries of the pension scheme	No
Non adjusting events - events after the balance sheet date	S151 Officer makes the assessment. If the event is indicative of conditions. that arose after the balance sheet date then this is an unadjusting event. 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	All Directors to notify S151 Officer	This would be considered on. individual circumstances	This would be considered on individual circumstances	N/A

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	Measured per CIPFA code of Practice	The financial instruments are measured by the Finance Manager and reviewed by the Director of Resources	No	Would take advice from financial professionals if required	No
Overhead Allocation	Charged in accordance with the costing principles of the CIPFA SeRCOP	Finance Manager calculates allocation and this is reviewed by Director of Resources	No	Apportionment bases are reviewed each year to ensure equitable	No
Bad Debt Provision.	A provision is estimated using a proportion basis of an aged debt listing.	Finance Manager calculates provision and this is reviewed by Director of Resources	No	Considered each year	No

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?
Provisions 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 amount of the obligation. Provisions are charged as an expense to the appropriate service line 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.	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.	No

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 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 available information has been used.	No

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