

## Informing the audit risk assessment for Shropshire and Wrekin Fire and Rescue Authority

Year ended 31 March 2016

21 April 2016

**Mark Stocks**

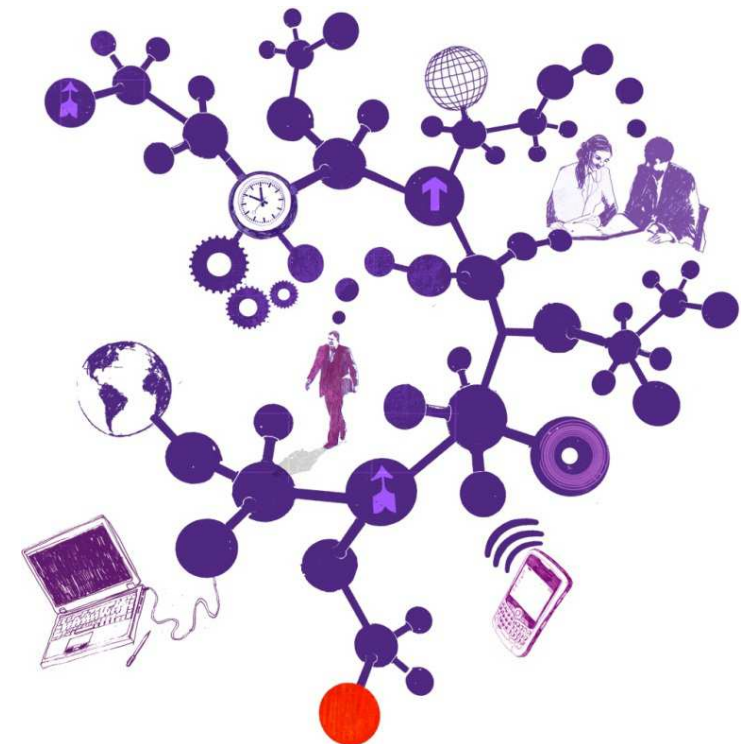
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# Purpose

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

This two-way communication assists both the auditor and the Audit and Performance Management 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 Performance Management Committee and supports the Audit and Performance Management 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 Performance Management 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 Performance Management 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 and Performance Management Committee and management. Management, with the oversight of the Audit and Performance Management 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 Performance Management 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 Performance Management 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 Performance Management Committee oversees the above processes. We are also required to make inquiries of both management and the Audit and Performance Management 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
<p>Has the Authority assessed the risk of material misstatement in the financial statements due to fraud or error? What are the results of this process?</p>	<p>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.</p> <p>The risk of material misstatement of the accounts due to undetected fraud is low.</p>
<p>How is the Authority satisfied that the overall control environment is robust. In particular, what processes does the Authority have in place to identify and respond to risks of fraud?</p>	<p>The Authority's Annual Government Statement reviews the effectiveness of and gives assurances on its internal controls and governance arrangements.</p> <p>The Internal Audit plan incorporates consideration of potential fraud. Those areas perceived to be at risk from fraudulent activity are identified and reviewed as part of the internal audit process.</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>There are no material instances of fraud that have been identified during the year. There are some areas that are inherently at risk from fraud such as cash and payroll. However, the Authority takes part in the National Fraud Initiative. No material issues identified to date.</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>Internal Audit include fraud risks in their planning process and act as an effective internal control against fraud.</p> <p>The Annual Governance Statement, which reviews the effectiveness of the Fire Authority's systems of internal control and governance arrangements, has not identified any significant issues.</p> <p>Segregation of duties are reviewed by Audit, and the Authority is confident that the controls in place reflect the risk present.</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</p>

## Fraud risk assessment (Continued)

Question	Management response
<p>How does the Audit and Performance Management Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control?</p> <p>What arrangements are in place to report fraud issues and risks to the Audit and Performance Management Committee?</p>	<p>The Audit and Performance Management Committee review and consider the Anti Fraud Bribery and Corruption Strategy, and recommend its approval to the Fire Authority. The Whistleblowing Policy is also reviewed and recommended to the Authority.</p> <p>Internal Audit provide the Committee with updates of their work on fraud prevention and detection, which would include any significant identified frauds and any action taken.</p>
<p>How does the Authority communicate and encourage ethical behaviour of its staff and contractors?</p>	<p>Through the Anti Fraud and Corruption Strategy, staff are encouraged to report concerns in the first instance to their line manager, or if this is not appropriate, to a senior manager. Senior management are then responsible for following up any allegation of fraud or corruption quickly to the Treasurer, or if this is not appropriate, to Internal Audit Services. A Brigade Order on Whistleblowing is also available to staff, which gives details about the support and safeguards that are available to those who do raise concerns.</p>
<p>How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?</p>	<p>Staff are encouraged to report any potential fraudulent activity, such as inappropriate use of cash and financial resources, incorrect claims for activities carried out on behalf of the Service, or inappropriate dealings with suppliers. No significant issues have been reported.</p>
<p>Are you aware of any related party relationships or transactions that could give rise to risks of fraud?</p>	<p>Both members and senior officers from the organisation are required to complete a related party transactions return as part of the year end closedown process, and no related party relationships have been identified that present a risk of fraud.</p> <p>A Declaration of Interests register is also in place for members to declare any business interests.</p>
<p>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 2015?</p>	<p>No</p>
<p>Are you aware of any whistleblower reports or reports under the Bribery Act since 1 April 2015?</p> <p>If so how does the Audit and Performance Management Committee respond to these?</p>	<p>No</p>

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# 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 and Performance Management 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 Performance Management 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
<p>What arrangements does the Authority have in place to prevent and detect non-compliance with laws and regulations?</p>	<p>Notice of any changes to laws and regulations, via circulars and government correspondence will be communicated to Senior Management Team and allocated to the relevant officer. Membership of national groups and communication with stakeholders and professional associations also ensure that management are kept informed of developments.</p> <p>The Monitoring Officer also alerts officers to any legislative changes which are likely to affect the Fire Authority</p> <p>Officers throughout the service will ensure that operations within their respective areas are carried out within up to date and appropriate regulatory frameworks and codes of practice.</p>
<p>How does management gain assurance that all relevant laws and regulations have been complied with?</p>	<p>The Senior Management Team has responsibility for ensuring the Authority is compliant with laws and regulations as detailed in the Brigade Orders. The Human Resources Manager has the largest responsibility as much legislation relates to people issues, but the Chief Fire Officer (CFO) takes responsibility for general Fire legislation and the Information Manager covers Data Protection etc. The Authority also has a delegated Treasurer who oversees financial transactions and ensures that the relevant laws and regulations are complied with. The Monitoring Officer is a member of the Senior Management Team and attends monthly meetings. The Monitoring Officer is consulted about changes in legislation and provides advice and legal comment when required.</p>
<p>How is the Audit and Performance Management Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>The Treasurer attends the Committee providing assurance where required and the Committee receives the Annual Governance Statement on an annual basis. The CFO attends where specific issues arise and the Committee has the power to call other Senior Officers to the meetings as and when required.</p>

## Impact of Laws and regulations (Continued)

Question	Management response
Have there been any instances of non-compliance or suspected non-compliance with law and regulation since 1 April 2015, or earlier with an on-going impact on the 2015/16 financial statements?	There have been no claims or litigation relating to non compliance.
What arrangements does the Authority have in place to identify, evaluate and account for litigation or claims?	The Fire Authority would review and investigate proportionately any instances that arose, and a review of existing processes would be undertaken to prevent further issues of non compliance in this area.
Is there any actual or potential litigation or claims that would affect the 2015/16 financial statements?	No
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	No

# 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 the Authority's 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.

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 Authority 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 Authority's financial resilience. It may indicate that some classes of assets or liabilities should not be valued on an on-going basis.

We discuss the going concern assumption with key Authority officers and review the Authority's financial and operating performance.

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

# Going Concern Considerations

Question	Management response
Does the Authority have procedures in place to assess the Authority's ability to continue as a going concern?	Long term strategic financial planning is in place (to 2020) to ensure that the service is sustainable into the future, and this is based on best estimates of future financial settlements. Reserves and human resources are also modelled to ensure continuation of service into the long term, and plans are currently in place to remodel service delivery in line with available resources.
Is management aware of the existence of events or conditions that may cast doubt on the Authority's ability to continue as a going concern?	No
Are arrangements in place to report the going concern assessment to the Audit and Performance Management Committee?	<p>The Treasurer and Head of Finance are both satisfied that the budget proposals are based on robust estimates, and that the level of reserves is adequate. This is communicated to the Committee at the point that the draft financial statements are discussed.</p> <p>The Authority also considers and approves the level of reserves proposed by Officers which is discussed alongside strategic plans in the Authority's Strategic Planning Group. This information is incorporated within the Service Plan, which is also shared with members.</p>
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 Service Plan incorporates financial planning, service transformation and service planning. It has been prepared by appropriately qualified and experienced staff in consultation with other Officers. Each element of the plan is consistent in terms of timescales and availability of resources required. Reports presented to members during the year are consistent with the budget set.

## Going Concern Considerations (Continued)

Question	Management response
<p>Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?</p>	<p>The Service Plan considers the government changes in terms of grant settlement and the financial settlement, as far as they can be estimated, and the impact of these changes are clearly set out. The plan is updated to reflect changes in the financial settlement as they become known.</p>
<p>Have there been any significant issues raised with the Audit and Performance Management Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal audit regarding financial performance or significant weaknesses in systems of financial control).</p>	<p>No</p>
<p>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?</p>	<p>No</p>
<p>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?</p>	<p>Yes</p>

# Related Parties

## Issue

### Matters in relation to Related Parties

Fire authorities 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 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.

Question	Management response
<p>What controls does the Authority have in place to identify, account for and disclose related party transactions and relationships?</p>	<p>A number of arrangements are in place for identifying the nature of a related party and reported value including:</p> <ul style="list-style-type: none"> <li>- 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.</li> <li>- An 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.</li> <li>- Review of in-year income and expenditure transactions with known identified related parties from prior year or known history.</li> <li>- Review of the accounts payable system and identification of amounts paid to assisted or voluntary organisations (no such payments are currently made).</li> </ul>

# Accounting estimates

## Issue

### Matters in relation to accounting estimates

Fire authorities need to apply appropriate estimates in the preparation of their financial statements. ISA (UK&I) 540 sets out requirements for auditing accounting estimates. The objective is to gain evidence that the accounting estimates are reasonable and the related disclosures are adequate.

Under this standard we have to identify and assess the risks of material misstatement for accounting estimates by understanding how the Authority 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 material estimates that the Authority 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.

Accounting estimates considerations have been set out below and management has provided its response.

Question	Management response
Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable?	Yes
How is the Audit and Performance Management Committee provided with assurance that the arrangements for accounting estimates are adequate?	Members of the Audit and Performance Management Committee receive and consider the statement of accounts, which contains the accounting policies associated with the financial statements. The Committee reviews the statement, and all variances of 10% or more on the previous statement are challenged and discussed. Any issues raised following the audit of the statement of accounts will be reported to the Committee.

# 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 an external valuer.	The Head of Finance notifies the valuer of changes to the estate from the prior year	Use the external valuer (RICS qualified)	Valuations are made in-line with the CIPFA Code of Practice 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.	Use the external valuer (RICS qualified)	The useful lives of property are recorded in accordance with the recommendations of the external RICS qualified valuer.	No
Depreciation	Depreciation is provided for on property plant and equipment with a finite useful life on a straight-line basis	Consistent application of depreciation method across assets	No	The length of the life is determined at the point of acquisition or revaluation.	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?
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 valuer (RICS qualified)	Valuations are made in-line with the CIPFA Code of Practice guidance - reliance on expert	No
Non adjusting events - events after the balance sheet date	The Authority follows the requirements of the CIPFA Code of Practice.	The Head of Finance notifies the Treasurer.	This would be considered on individual circumstances	This would be considered on individual circumstances	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?
Measurement of Financial Instruments	Measurements are obtained from appropriate sources. The Authority follows the requirements of the CIPFA Code of Practice.	The financial instruments are measured by the Head of Finance and the accounts are reviewed by the Treasurer.	No	The measurements are based upon the best information held at the current time and are provided as appropriate by experts in their field.	No
Creditor accruals	Accruals are estimated by reviewing goods and services received prior to the end of the financial year for which an invoice has not been received.	The date of receipt of the goods and services is used in the estimation of the accrual.	No	The use of actual dates of receipt of goods and services gives a low degree of uncertainty.	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 Fund Actuarial gains/losses	The actuarial gains and losses figures are calculated by the actuarial expert , Mercers. These figures are based on making % adjustments to the closing values of assets/liabilities.	For the Firefighters' pension scheme the Authority makes interim and final submission to the actuary. These are tested internally by the Authority who also responds to queries raised by the actuary on the interim submission. For the LGPS the Authority responds to queries raised by the administering authority Shropshire Council who administers the pensions system on behalf of the Authority.	The Authority are provided with an actuarial report by Mercers for both the LGPS and the Firefighters' Pension Fund.	The nature of these figures forecasting into the future are based upon the best information held at the current time and are developed by experts in their field.	No
Pension Fund Liabilities (LGPS & Firefighters pension scheme)	The liabilities figures are calculated by the actuarial expert Mercers. These figures are based on a set of assumptions	The Authority responds to queries raised by the administering body – Shropshire Council	The Authority uses an expert Mercers to provide an actuarial report	The nature of these figures forecasting into the future are based upon the best information held at the current time and are developed by experts in their field.	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?
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 line in the CI&ES 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 if it is virtually certain that reimbursement will be received by the Authority	No



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