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# **Communication**

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# **with the Auditor**

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**Shropshire & Wrekin Fire and Rescue Authority**

**Audit 2011/12**

**The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.**

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# Introduction

**The purpose of this report is to ensure there is effective two-way communication between the Authority's Audit & Performance Management Committee, who are 'those charged with governance' and the Engagement Lead, the Authority's external auditor.**

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

**2** In planning and performing my audit of the financial statements I need to understand how the Committee, supported by the Authority's management, meets its responsibilities in the following areas.

- Fraud
- Law and regulation
- Going concern
- Related parties
- Accounting for estimates

**3** This report summarises the responsibilities in each of these areas, as explained in the International Standards on Auditing (UK and Ireland) (ISAs). My primary responsibility is to consider the risk of material misstatement.

**4** Each section of the report includes a series of questions that management have responded to. I would like to ask the Committee to consider these responses to me and confirm that they are satisfied with the arrangements.

# Fraud Risk Assessment

5 The 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]**

6 The primary responsibility to prevent and detect fraud is with the Committee and the Authority's management. To do this:

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

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

8 I am also required to carry out a fraud risk assessment to inform my audit approach. This includes considering the following.

- How management assesses the risk of material misstatement in the financial statements due to fraud.
- Management's response to assessed fraud risk, including any identified specific risks.
- How management communicates its process for assessing and responding to fraud risk to the Committee.
- How management communicates its views on ethical behaviour to Officers.
- How the Committee exercises oversight of management's fraud risk assessment and response processes and the internal controls to mitigate these risks.
- What knowledge the Committee has of actual, alleged or suspected fraud.

9 To help me in making my fraud risk assessment management have responded to the following questions.

Table 1: **Fraud Risk Assessment**

Question	Management Response
<p>1. What is Management's assessment of the risk of material misstatement in the financial statements due to fraud.</p>	<p><i>Although there is an ongoing 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.</i></p> <p><i>The risk of material misstatement of the accounts due to undetected fraud is low.</i></p>
<p>2. Are you aware of any instances of fraud, either within the Authority as a whole or within specific departments since 1 April 2011?</p>	<p><i>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.</i></p>
<p>3. Do you suspect fraud may be occurring, either within the Authority or within specific departments?</p> <ul style="list-style-type: none"> <li>– Have you identified any specific fraud risks?</li> <li>– Do you have any concerns there are areas that are at risk of fraud?</li> <li>– Are there particular locations within the Authority where fraud is more likely to occur?</li> </ul>	<p><i>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 Shropshire &amp; Wrekin Fire and Rescue Authority.</i></p> <p><i>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.</i></p>
<p>4. Are you satisfied that internal controls, including segregation of duties, exist and work effectively?</p> <ul style="list-style-type: none"> <li>– If not where are the risk areas?</li> <li>– What other controls are in place to help prevent, deter or detect fraud?</li> </ul>	<p><i>Yes - Internal Audit include fraud risks in their planning process and act as an effective internal control against fraud.</i></p> <p><i>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.</i></p>

Question	Management Response
	<p><i>In addition, segregation of duties are reviewed by Audit. Some issues have been identified but the Authority is confident that the controls in place reflect the risk present.</i></p>
<p>5. How do you encourage staff to report their concerns about fraud?</p> <ul style="list-style-type: none"> <li>– What concerns are staff expected to report about fraud?</li> </ul>	<p><i>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.</i></p> <p><i>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.</i></p> <p><i>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.</i></p>
<p>6. From a fraud and corruption perspective, what are considered to be high-risk posts?</p> <ul style="list-style-type: none"> <li>– How are the risks relating to these posts identified, assessed and managed?</li> </ul>	<p><i>There are no posts which are considered high risk from a fraud perspective. Those posts with responsibility for financial and physical resources or procurement, or staff making or authorising payroll claims are considered at higher risk of committing fraud. However, processes and procedures are in place to ensure that payroll claims are administered and completed correctly. The Annual Governance Statement details the system in place to ensure financial controls and governance arrangements are</i></p>

Question	Management Response
<p>7. Are you aware of any related party relationships or transactions that could give rise to instances of fraud?</p> <ul style="list-style-type: none"> <li>– How do you mitigate the risks associated with fraud related to related party relationships and transactions?</li> </ul>	<p><i>in place.</i></p> <p><i>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.</i></p> <p><i>A Declaration of Interests register is also in place for members to declare any business interests.</i></p>
<p>8. What arrangements are in place to report fraud issues to the Committee?</p>	<p><i>Internal Audit provide the Committee with updates of their work on fraud prevention and detection, including any significant identified frauds and the action taken. No significant fraud identified in 2011/12.</i></p>



# Law and Regulation

**10** The ISAs (ISA (UK&I) 250) require me to consider the impact that law and 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 International Financial Reporting Standards, the Code of Accounting for Local Authorities in England 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; and
- litigation and claims against the Authority.

**11** Where I become aware of information about a possible instance of non-compliance I need to gain an understanding of it to evaluate the possible effect on the financial statements.

**12** The ISAs also require me to make enquiries of management and the Committee about the arrangements in place to comply with law and regulation. To help me management have responded to the following questions.

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Table 2: **Law and Regulation**

Question	Management Response
1. How does management gain assurance that all relevant laws and regulations have been complied with.	<i>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 CFO takes responsibility for general Fire legislation and the Information Manager covers Data Protection etc. The Authority also has a delegated Section 114 Officer who oversees financial transactions and ensures that the relevant laws and regulations are complied with.</i>

Question	Management Response
<p>2. How is the Committee provided with assurance that all relevant laws and regulations have been complied with.</p>	<p><i>The Treasurer attends the Committee providing assurance where required and they receive 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.</i></p>
<p>3. Have there been any instances of non-compliance with law and regulation since 1 April 2011.</p>	<p><i>None</i></p>
<p>4. Is there any actual or potential litigation or claims that would affect the financial statements.</p>	<p><i>None</i></p>

# Going Concern

**13** Going concern' is a key concept in the preparation of the financial statements for the Authority. 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).

**14** The going concern assumption is a fundamental principle in the preparation of financial statements. 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.

**15** 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 ongoing basis.

**16** I discuss the going concern assumption with key Authority officers and review the Authority's financial and operating performance. Below are key questions on the going concern assumption which I would like the Committee to consider.

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Table 3: **Going Concern**

Question	Response
1. Has a report been received from management forming a view on going concern?	<p><i>The Treasurer (as s114 Officer) 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.</i></p> <p><i>The Authority also considers and approves the level of reserves proposed by Officers which requires an understanding of the Medium Term Corporate Plan which includes the Medium Term Financial Plan.</i></p>

Question	Response
<p>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?</p>	<p><i>The Medium Term Financial Plan has been prepared by appropriately qualified and experienced staff in consultation with other Officers and budget holders. The appropriate committees reviewed their respective financial plans before approval. The financial assumptions are therefore consistent with the Authority's Corporate Plan. Reports in year are consistent with the budget set.</i></p>
<p>3. Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?</p>	<p><i>The Medium Term Financial Plan explicitly considered the government changes in terms of grant settlement and the financial settlement. Whilst there are unknowns for 2015/16, the next three years are clearly set out. The plan is updated to reflect changes in the financial settlement as they are known.</i></p>
<p>4. Have there been any significant issues raised with the 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).</p>	<p><i>None</i></p>
<p>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?</p> <p>If so, what action is being taken to improve financial performance?</p>	<p><i>No</i></p>

Question	Response
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

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# Accounting Estimates

**17** 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.

**18** Under this standard I 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. This will include assessing the estimation uncertainty for each material estimate to conclude how likely it is that an error could occur.

**19** 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 is using as part of their accounts preparation; these are detailed in appendix 1 to this report.

**20** 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.

## Related Parties

**21** For local government bodies, the Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 (the Code) requires compliance with IAS 24: Related party disclosures. Paragraph 3.9.2.5 of 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;
- 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.

**22** Paragraph 3.9.1.3 of 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.

**23** ISA (UK&I) 550 requires me to review your procedures for identifying related party transactions and obtain an understanding of the controls that you have established to identify such transactions. I will also carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate.

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Table 4: **Related Parties**

Question	Response
1. Who are the Authority's related parties?	<i>The Authority has a significant 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 SORP).</i>

Question	Response
	<p><i>The areas where these are disclosed within the Authority's financial statements are:</i></p> <p><i>(1) Government - central government grants has control influence over the Authority as the Authority needs to act in accordance with its statutory responsibilities.</i></p> <p><i>(2) 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.</i></p> <p><i>(3) Other public bodies - the Authority has a number of joint working arrangements which result in relationships with influence over or from the joint working party.</i></p>
<p>2. What are the controls in place to identify, account for, and disclose, related party transactions and relationships?</p>	<p><i>A number of arrangements are in place for identifying the nature of a related party and reported value including:</i></p> <ul style="list-style-type: none"> <li>■ <i>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.</i></li> <li>■ <i>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.</i></li> <li>■ <i>Review of in-year income and expenditure transactions with known identified related parties from prior year or known history.</i></li> <li>■ <i>Review of the accounts payable system and identification of amounts paid to assisted or voluntary organisations.</i></li> </ul>



## Appendix 1 Accounting Estimates

Table 5: 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 & equipment valuations	Valuations are made by the County Valuer in-line with RICS guidance on the basis of 5 year valuations with interim reviews.	Head of Finance notifies the valuer of the program of rolling valuations or of any conditions that warrant an interim re-valuation.	Use the County Valuer	Valuations are made in-line with RICS guidance - reliance on expert.	No change in method but due to component accounting, more assets to value in 2011/12
Estimated remaining useful Lives of PPE	The estimated asset life of each building is provided by the Valuer and revised as necessary at each valuation.  Vehicles, plant and equipment is depreciated in full over the estimated asset life, as advised by a suitably qualified officer.	Consistent asset lives applied to each asset category	Use the External Valuer or other suitably qualified officer	The method makes some generalisations but is made based upon the professional judgement of the Valuer. This life would be recorded in accordance with the local qualified RICS or CIB 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?
	Where an item of Property Plant and Equipment has major components whose value makes up more than 25% of the total asset value, the components are depreciated separately.				
Depreciation & Amortisation	Depreciation is provided for on all fixed assets with a finite useful life on a straight-line basis.	Consistent application of depreciation method across all assets	No	The length of the life is determined at the point of acquisition or revaluation. Depreciation is applied for each year  Assets that are not fully constructed are not depreciated until they are brought into operational use.	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?
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	Valuations are made in-line with RICS guidance - reliance on expert.	No
Non adjusting events - events after the BS date	The s114 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.	Senior Officers notify the s 114 Officer of any circumstances which may give rise to a disclosure in the financial statements.	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	The Authority values financial instruments at fair value based on the advice of finance professionals and information in the public domain.	Reference judgement with information in the public domain where possible.	Yes	Reference judgement with information in the public domain where possible.	No
Bad Debt Provision	A provision is estimated using a proportion basis of an aged debt listing	Members of the Finance team calculate the aged debt listing and the provision	No	Consistent proportion used across aged debt as per the SORP.	No
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.	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.	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 are charged as an expense to the appropriate service 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.			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.	
Accruals	The finance team collates accruals for income and expenditure. 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

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?
Finance leases	Fixed assets recognised under finance leases are accounted for using the policies applied generally to tangible fixed assets, 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 as a finance lease or an operating lease	No	Property, Plant and Equipment recognised under finance leases are accounted for using the policies applied generally to such assets, subject to depreciation being charged over the lease term if this is shorter than the asset's estimated useful life (where ownership of the asset does not transfer to the Authority at the end of the lease period).	Yes - the Authority has undergone a review of leases during 2011/12.
Employment - Holiday pay accrual	An accrual is made for the cost of holiday entitlements earned by employees but not taken before the year-end which employees can carry forward into the next financial year.	Finance take a representative sample of employees from each grade from the HR information held and extrapolate for all staff.	No	The accrual is made at the salary rates applicable in the following accounting year, being the period in which the employee takes the benefit.	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?
Defined benefit pension amounts and disclosures	<p>All firefighters are eligible to join the Fire Pension Scheme which is legally administered by the Fire Authority, but Shropshire County Council provides support through an SLA for preparation of the figures for the financial statements.</p> <p>Non firefighting employees of the Authority are eligible to be members of the local government pension scheme, administered locally by Shropshire County Council.</p>	Rely on the calculations made by the actuaries	The actuaries of the pension schemes	Reliance on the expertise of the actuaries of the pension schemes	No
Contingent Liabilities	Contingent liabilities are not recognised in the Balance Sheet but disclosed in a note to the accounts.	Finance act upon an event that has taken place that gives the Authority a possible liability	No	Where practicable an estimate of the financial effect, an indication of the uncertainties relating to the timing of the outflow and the possibility of any reimbursement will be disclosed.	No

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