

Informing the audit risk assessment for Coventry City Council

Year Ended 31 March 2019

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Purpose

The purpose of this report is to contribute towards the effective two-way communication between those charged with governance for Coventry City Council ("Council"), and Grant Thornton as your external auditor. The report covers some important areas of the auditor risk assessment where we are required to make inquiries to the Council 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 Procurement Committee. ISA(UK&I) emphasise the importance of two-way communication between the auditor and the Council and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Audit and Procurement 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 Council and supports the Audit and Procurement 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 the Council management processes and the Audit and Procurement 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 Council's management. These responses have been reviewed and agreed by the relevant heads of departments.

The Audit & Procurement Committee should consider whether these responses are consistent with 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 Procurement Committee and the Council management. Management, with the oversight of the Audit and Procurement 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 Procurement Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As the Council's external auditors, 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 Procurement 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 Procurement Committee oversees the above processes. We are also required to make inquiries of both the Council management and the Audit and Procurement Committee as to their knowledge of any actual, suspected or alleged fraud. These areas have been set out in the fraud risk assessment questions below together with responses from the Council's management.

Fraud risk assessment

Question	Management response
<p>Has the Council assessed the risk of material misstatement in the financial statements due to fraud, including the nature, extent and frequency of such assessments? (wording change)</p>	<p>The authority's assessment is that this risk of material misstatement is low. The financial statements are subject to internal quality assurance control checks including : i) checks for high risk activities and ii) analytical reviews with the objective of identifying any significant year on year variances. Further risk assessment processes related to the preparation of accounts will be completed based upon any audit issues raised by both Internal and External Audit. The quarterly monitoring of service revenue and capital budgets will identify any risk of material misstatements.</p>
<p>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? (Wording change)</p>	<p>The work of the Internal Audit service focuses on four areas: Council Tax, the National Fraud Initiative, referrals and investigations considered through the Council's Fraud and Corruption Strategy and proactive work. All suspected cases of fraud, theft, corruption should be notified to Acting Chief Internal Auditor. Anti Fraud & Corruption and Whistle Blowing Policies in place.</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>The work outlined above is designed to focus on the areas deemed to be of the highest risk. Investigations of suspected fraud, as a result of cases brought to the attention of the Acting Chief Internal Auditor, are carried out by the Internal Audit team.</p> <p>No Significant fraud risk has been identified. Locations handling income, particularly in the form of cash, are more likely to be at risk of fraud but these are not significant.</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>Sound systems of internal control with roles and responsibilities are defined in various places such as the Constitution and the Rules for Contracts or enforced through ICT system controls and monitoring. The role of internal audit provides assurance that internal controls are in place and operating effectively. Where areas for improvement are identified these are included in internal audit reports. The Chief Internal Auditor provides an annual opinion on the Council's control environment. Services controls e.g. segregation of duties of officers to mitigate fraud, are in place to support the Council's Anti-Fraud and Corruption Strategy and Whistle Blowing Policy.</p>

Fraud risk assessment (continued)

Question	Management response
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.
Are there any areas where there is a potential for misreporting override of controls or inappropriate influence over the financial reporting process?	None known.
How does the Council communicate with those charged with governance regarding their processes for identifying and responding to risks of fraud in the entity?	The Audit and Procurement Committee receive a half yearly report on corporate fraud.

Fraud risk assessment (continued)

Question	Management response
How does the Council communicate ethical behaviour of its staff and contractors?	Council policies for business practices and ethical behaviour are on the council's intranet site. When these have been updated / revised this is highlighted in the daily beacon emails to all staff.
How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?	Employees should be aware of the anti-fraud and corruption strategy, details are available on the Intranet and induction training for all new staff covers fraud and corruption awareness. The Acting Chief Internal Auditor investigates all cases of suspected fraud. No significant issues were highlighted in the most recent report.
Are you aware of any related party relationships or transactions that could give rise to risks of fraud?	Most of the related party transactions that could give rise to potential fraud are those in which Councillors have a direct interest. Risks are mitigated by Councillors' declaration of interests and non-participation in debates. Officers are also expected to declare any potential interest or conflict.
Are you aware of any instances of actual, suspected, or alleged fraud either within the Council as a whole or within specific departments since 1 April 2018?	No.
Are you aware of any whistle-blower reports or reports under the Bribery Act since 1 April 2018?	No.
If so how does the Audit and Procurement Committee respond to these?	

Fraud risk assessment (continued)

Question	Management response
How does the Council protect itself against Fraud in its Group activities?	In putting together its Annual Governance Statement the Council undertakes a review of the effectiveness of the system of internal control within its group activities.

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 Procurement Committee, is responsible for ensuring that the Council's operations are conducted in accordance with laws and regulations including those that determine amounts in the financial statements.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error, taking into account the appropriate legal and regulatory framework. As part of our risk assessment procedures we are required to make inquiries of management and the Audit and Procurement 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 overleaf together with responses from management.

Impact of laws and regulations

Question	Management response
What arrangements does the Council have in place to prevent and detect non-compliance with laws and regulations?	<p>The Monitoring Officer and the Council's legal team advise the Council's Leadership, Councillors and departments on changes to the legal and regulatory environment that impact on the Council.</p> <p>Employees are expected to keep themselves updated of laws and regulations related to their area of work.</p> <p>Suspected non-compliances with laws and regulations will be investigated.</p>
How does management gain assurance that all relevant laws and regulations have been complied with?	<p>Through effective governance processes and review mechanisms such as internal audit. The Monitoring Officer and the Council's legal team advise the Council's Leadership, Councillors and departments on changes to the legal and regulatory environment that impact on the Council.</p>
How is the Audit and Procurement Committee provided with assurance that all relevant laws and regulations have been complied with?	<p>The Annual Governance Statement presented to the Committee provides assurance that arrangements are in place for facilitating effective exercise of the Council's functions. This includes ensuring that its business is conducted in accordance with the law and proper standards.</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 regulations since 1 April 2018, or earlier with an on-going impact on the 2018/19 financial statements?	No.
What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?	Corporate finance undertake discussions with the City Solicitor and Monitoring Officer to identify any significant litigation claims at the year end.
Is there any actual or potential litigation or claims that would affect the financial statements?	In October 2018 the Court of Appeal rejected the application by the owners of Coventry City Football Club to appeal the decision which had previously denied it the opportunity to challenge the sale of shares in ACL to by the Council to Wasps RFC.
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate noncompliance?	No
What arrangements does the Council have in place to prevent and detect non-compliance with laws and regulations within its Group activities?	The Council undertakes a review of the effectiveness of the system of internal control within group activities. The Council also appoints representatives to sit on the Boards of companies within its group activities.

Going Concern

Matters in relation to going concern

ISA(UK&I)570 covers auditor responsibilities in the audit of financial statements relating to management's use of the going concern assumption in the financial statements.

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

The code of practice on local authority accounting requires an authority's financial statements to be prepared on a going concern basis.

Although the Council is not subject to the same future trading uncertainties as private sector entities, consideration of the key features of the going concern provides an indication of the Council's financial resilience and is good practice.

As auditor, we are responsible for considering the appropriateness of use of the going concern assumption in preparing the financial statements and to consider whether there are material uncertainties about the Council's ability to continue as a going concern that need to be disclosed in the financial statements. We discuss the going concern assumption with management and review the Council's financial and operating performance.

Going concern considerations are set out overleaf and management has provided its response.

Going concern considerations

Question	Management response
Is the going concern basis of accounting a fundamental principle in the preparation of the financial statements ?	Yes.
Has a preliminary assessment of the Council's ability to continue as a going concern been performed?	Yes.
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 ?	Going concern is considered on an annual basis as part of the preparation of the financial statements. This review considers key areas that impact on the Council's ability to continue as a going concern, e.g. financial resilience, contingent liabilities, budgets and medium term financial forecasts. The Council's relatively healthy financial position in 2018/19 and balanced budget for 2019/20, together with the early work that has begun for reviewing the medium term financial position provide support for the Council's going concern assumption. The outcome of the current review of the future of local government finance in 2019 will provide an update on the degree to which this position will come under pressure.
Are arrangements in place to report the going concern assessment to the Audit and Procurement Committee?	The going concern assumption will form part of the statutory reporting of the accounts.

Going concern considerations (continued)

Question	Management response
Are the financial assumptions in that report (e.g. future levels of income and expenditure) consistent with the Council's Business Plan and the financial information provided to the Council throughout the year?	The reporting undertaken at year-end is made with reference to the Council's budget plans and regular monitoring through the year.
Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	Yes. All known changes which impact upon the financial projections will be factored in.
Have there been any significant issues raised with the Audit and Procurement Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).	No.
Does a review of available financial information identify any adverse financial indicators including negative cash flow? If so, what action is being taken to improve financial performance?	No.

Going concern considerations (continued)

Question	Management response
Does the Council have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Council's objectives? If not, what action is being taken to obtain those skills?	There are sufficient staff in post with the appropriate skills and experience. The level of the challenge to deliver the Council's plans and programmes is substantial but there are no significant instances where this is impacting on the delivery of objectives.
What arrangements does the Council have in place to ensure that its Group activities are a Going Concern?	The Council receives financial information that enables it to monitor the going concern position of its group activities.

Related Parties

Matters in relation to Related Parties

For local government bodies, the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) requires compliance with 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 Council (i.e. subsidiaries);
- associates and/or joint ventures;
- an entity that has an interest in the Council that gives it significant influence over the Council;
- 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 Council, or of any entity that is a related party of the Council.

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 Council's perspective but material from a related party viewpoint then the Council must disclose it.

ISA (UK&I) 550 covers auditor responsibilities relating to related party transactions.

Many related party transactions are in the normal course of business and may not carry a higher risk of material misstatement. However in some circumstances the nature of the relationships and transaction may give rise to higher risks.

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 overleaf and management has provided its response.

Related Parties considerations

Question	Management response
<p>What controls does the Council have in place to identify, account for, and disclose related party transactions and relationships?</p>	<p>Related party transactions and relationships re reported within the statutory accounting process through analysis of existing disclosure records and a process to collect information on these relationships.</p>

Related Parties considerations (continued)

Question	Management response
Who are the Council's related parties, including changes from prior period?	The process to identify related parties will be undertaken as part of the year-end statutory accounting process and will be disclosed in a separate note to the accounts.
Has the Authority entered into any transactions with these related parties during the period, if so, what are the type and purpose of these transactions?	Related party transactions will be set out within the separate note to the accounts.

Related Parties considerations (continued)

Question	Management response
<p>What arrangements does the Council have in place to ensure that its Group activities correctly identify and account for related party transactions?</p>	<p>Each grouped company produces accounts which set out any related party transactions. The accounts are subject to external audit and are made available to the Council.</p>

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. 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 Council 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 Council is using as part of its accounts preparation; these are detailed in Appendix A. 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 overleaf and management has provided its response.

Accounting estimates considerations

Question	Management response
Are the management arrangements for the accounting estimates, including identifying new estimates or revisions required, detailed in Appendix A reasonable?	Yes. Where estimation is necessary, appropriate estimating methodology is utilised. Estimates will be prepared by those best qualified, e.g. Pension Fund Actuary to supply estimates relating to IAS 19 – Employee Benefits, assets are professionally valued.
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? (New wording)	The elements identified in Appendix A are likely to cover the relevant areas that require an accounting estimate within the accounts. Any other need for estimation will be identified by officers involved in compiling the financial accounts.
Are there any changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates? (New wording)	Accounting estimates are refreshed each year. The Council will need to examine and requirement for new or revised estimates in relation to its new or relatively new relationships with Coombe Abbey Park Limited, the Friargate Joint Venture and the UK Battery industrialisation Centre.
How is the Audit and Procurement Committee provided with assurance that the arrangements for accounting estimates are adequate?	Accounting estimates are an integral part of the statutory accounting and reporting process.

Appendix A – Accounting Estimates

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 Head of Property (RICS qualified) from the Commercial Property department.	Valuer notified of changes to the estate from the prior year	Use of internal valuers (RICS qualified) from Commercial Property department for PPE.	Valuations are made in-line with the CIPFA Code of Practice guidance - reliance on expert	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?
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 of internal valuers (RICS qualified) from Commercial Property department	The useful lives of property are recorded in accordance with the recommendations of the internal 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 of internal valuers (RICS qualified) from Commercial Property department for PPE.	Valuations are made in-line with the CIPFA Code of Practice guidance - reliance on expert	No
Provision for doubtful debts	A provision is estimated using a proportion basis of an aged debt listing.	The corporate finance team calculate the provision.	No	Consistent proportion used across debt.	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 and recorded by the Corporate Finance Team using advice as appropriate from the Council's Treasury management advisors.	Yes	The measurements are based upon the best information held at the current time and are provided 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
Pension Fund Actuarial gains/ losses	The actuarial gains and losses figures are calculated by the actuarial experts(Barnett Waddingham) These figures are based on making % adjustments to the closing values of assets/liabilities.	For the LGPS the Authority responds to queries raised by the administering authority City of Wolverhampton Council.	The Authority are provided with an actuarial report by Barnett Waddingham (LGPS) .	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?
Pension Fund Actuarial gains/ losses					
Overhead allocation	The accountants apportion central support costs to services based on appropriate bases.	All support service cost centres are allocated according to the agreed processes.	No	Appropriate bases are reviewed each year to ensure equitable.	No
PFI liabilities	Estimates are made at the outset of PFI schemes based on established models. The models are agreed with our external auditors who have reviewed this extensively in recent years.	Given that estimates are established at the outset of the PFI scheme they are then determined for the life of the scheme, reflecting for example, the fixed cost or the debt financing within the scheme.	Yes, at the outset of the schemes or where re-financing of PFI debt is considered experts are used in line with standard practice.	Alternative estimates are not generally considered once the model has been established, unless there are major changes in the scheme (e.g. re-financing)..	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?
Long Term investments	Long Term Investments are valued at fair value.	Estimates are based on established valuation methodologies which use information available within accounting statements.	Yes	Valuations consider alternative bases of valuation.	No

