

# Informing the Audit Risk Assessment for Coventry City Council 2020/21

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# Purpose

The purpose of this report is to contribute towards the effective two-way communication between Coventry City Council's external auditors and Coventry City Council's Audit & Procurement 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 & Procurement Committee under auditing standards.

## Background

Under International Standards on Auditing (UK), (ISA(UK)) auditors have specific responsibilities to communicate with the Audit & Procurement Committee. ISA(UK) emphasise the importance of two-way communication between the auditor and the Audit & Procurement Committee and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Audit & 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 Audit & Procurement Committee and supports the Audit & 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 management processes and the Authority's oversight of the following areas:

- General Enquiries of Management
- Fraud,
- Laws and Regulations,
- Related Parties, and
- Accounting Estimates.

# Purpose

This report includes a series of questions on each of these areas and the response we have received from Coventry City Council's management. 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.

# General Enquiries of Management

Question	Management response
1. What do you regard as the key events or issues that will have a significant impact on the financial statements for 2020/21?	COVID-19 has had a massive impact on the Council both operationally and financially with Covid Grant funding and Business Rate reliefs for Coventry totalling more than £200m. The Council continues to support a range of major projects in the city as part of a Capital Programme that is very large in a historical context. Valuation of the Council's property asset portfolio and pension liability will continue to be areas that are most subject to significant volatility.
2. Have you considered the appropriateness of the accounting policies adopted by Coventry City Council? Have there been any events or transactions that may cause you to change or adopt new accounting policies?	We are not aware of any events or transactions at this stage that will lead to any changes to or adoption of new accounting policies. This will be kept under review during the final accounts process.
3. Is there any use of financial instruments, including derivatives?	There is no use of financial derivative instruments.

# General Enquiries of Management

Question	Management response
<p>4. Are you aware of any significant transaction outside the normal course of business?</p>	<p>The scale and nature of the Covid related activity was overwhelmingly outside of the normal course of business, providing an emergency operational response and supporting businesses and individuals via a range of reliefs, grants and in-kind support. In addition, the Council undertook loans to Coombe Abbey Park Ltd (to provide cashflow support) and Coventry and Warwickshire Reinvestment Trust (to facilitate it making onward loans to support businesses).</p> <p>The Council is increasing the extent of the activity that it undertakes through companies which it owns in part or on a 100% basis. Sherbourne Recycling Ltd (the company which will operate the Materials Recycling Facility in the city) came into the Council's part-ownership on 1<sup>st</sup> April 2021.</p>
<p>5. Are you aware of any changes in circumstances that would lead to impairment of non-current assets?</p>	<p>An annual impairment review of the Council's property assets is undertaken as a matter of course. The report of the external valuer has been received and will result in a number of impairment adjustments accordingly.</p>
<p>6. Are you aware of any guarantee contracts?</p>	<p>The Council provides pension guarantees to a number of organisations and is a guarantor for the UK City of Culture 2021.</p>
<p>7. Are you aware of the existence of loss contingencies and/or un-asserted claims that may affect the financial statements?</p>	<p>The 2019/20 accounts reported contingent liabilities for a potential of grant clawback on the Friargate Bridgedeck and a Business Rates relief claim. Other than these we are not aware of any significant contingencies or claims that are likely to affect the financial statements.</p>

# General Enquiries of Management

Question	Management response
8. Other than in house solicitors, can you provide details of those solicitors utilised by Coventry City Council during the year. Please indicate where they are working on open litigation or contingencies from prior years.	A transaction listing detailing our use of external legal support has been provided. No solicitors have been used on litigation which would have a significant impact on the Council's financial position.
9. Have any of Coventry City Council's service providers reported any items of fraud, non-compliance with laws and regulations or uncorrected misstatements which would affect the financial statements?	No.
10. Can you provide details of other advisors consulted during the year and the issue on which they were consulted?	The Materials Recycling Facilities Project has received external advice, the Council's share of which equates to a cost of £354,000. Other professional advice has been procured in relation to City Centre South (£328k), Very Light Rail £297k, Friargate (£197k) and the Collection Centre (£92k).

# Fraud

## Issue

### Matters in relation to fraud

ISA (UK) 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 & Procurement Committee and management. Management, with the oversight of the Audit & 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 & Procurement Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As Coventry City Council's external 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 & Procurement Committee regarding its processes for identifying and responding to risks of fraud, and
- communication to employees regarding business practices and ethical behaviour.

We need to understand how the Audit & Procurement Committee oversees the above processes. We are also required to make inquiries of both management and the Audit & 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 Coventry City Council's management.

# Fraud risk assessment

Question	Management response
<p>1. Has Coventry City Council assessed the risk of material misstatement in the financial statements due to fraud?</p> <p>How has the process of identifying and responding to the risk of fraud been undertaken and what are the results of this process?</p> <p>How do the Authority's risk management processes link to financial reporting?</p>	<p>The authority's assessment is that this risk of material misstatement is low.</p> <p>The quarterly monitoring of service revenue and capital budgets, financial outturn results and the subsequent financial statements should identify any material misstatements, including where this could be due to fraud.</p> <p>These processes are key components of the annual financial cycle and as such are carried out as part of business as usual. In addition the financial statements are subject to internal quality assurance control checks including analytical reviews with the objective of identifying any significant year on year variances.</p> <p>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.</p>
<p>2. What have you determined to be the classes of accounts, transactions and disclosures most at risk to fraud?</p>	<p>See above, the risk of fraud within the financial statements is considered to be low.</p>
<p>3. Are you aware of any instances of actual, suspected or alleged fraud, errors or other irregularities either within Coventry City Council as a whole or within specific departments since 1 April 2020?</p> <p>As a management team, how do you communicate risk issues (including fraud) to those charged with governance?</p>	<p>All concerns regarding fraud should be reported to the Chief Internal Auditor and defined processes are in place deal with any concerns raised. Since 1<sup>st</sup> April 2020 two concerns have been raised which could have implications on the financial statements. One concern has been subject to a formal report to Audit and Procurement Committee and action has been taken to reverse the transactions and ensure the accuracy of financial reporting. The other concern relates to a potential discrepancy in relation to cash administered via the self service kiosks at Broadgate House. At the current time this is still being investigated. Neither of these cases are material. In cases where fraud / error is identified through the work of Internal Audit as a result of third party actions (i.e the wider public) action is taken amend customer accounts / raise overpayments and recover monies wherever possible. This includes fraud / error in the Covid-19 business grant schemes which the Council have administered.</p> <p>The Council's corporate risk register is subject to regular review and is reported to the Audit and Procurement Committee. The Committee also receives a half yearly report on anti fraud and corruption activity.</p>

# Fraud risk assessment

Question	Management response
<p>4. Have you identified any specific fraud risks?</p> <p>Do you have any concerns there are areas that are at risk of fraud?</p> <p>Are there particular locations within Coventry City Council where fraud is more likely to occur?</p>	<p>A fraud risk register is maintained by Internal Audit and specific fraud risk assessments are undertaken where appropriate. There are specific fraud risks in relation to covid-19 business grant funding. These grant schemes are subject to individual risk assessments and pre and post payment assurance checks. The risk of fraud in relation to this does not impact on the integrity of the financial statements.</p> <p>Most risks around fraud relate to actions undertaken by third parties (i.e the wider public) to commit fraud against the Council. The risk of fraud in relation to financial reporting is assessed as low.</p>
<p>5. What processes does Coventry City Council have in place to identify and respond to risks of fraud?</p>	<p>The work of Internal Audit 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.</p> <p>In addition to this, a fraud risk register is maintained by Internal Audit and specific fraud risk assessments are undertaken where appropriate. This includes work undertaken to identify and respond to the risk of fraud in Covid-19 business grant schemes.</p>

# Fraud risk assessment

Question	Management response
<p>6. How do you assess the overall control environment for Coventry City Council, including:</p> <ul style="list-style-type: none"><li>• the existence of internal controls, including segregation of duties; and</li><li>• the process for reviewing the effectiveness the system of internal control?</li></ul> <p>If internal controls are not in place or not effective, where are the risk areas and what mitigating actions have been taken?</p> <p>What other controls are in place to help prevent, deter or detect fraud?</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>The Internal Audit Annual Report details the process for reviewing the effectiveness of the system of internal control and the results of this review. The last formal assessment of the Council's control environment was for the financial year 2019-20. The Chief Internal Auditor's opinion was that moderate assurance could be provided that there is generally a sound system of internal control in place. This means that there is generally an appropriate level of control for managing the majority of the significant inherent risks to the Council's objectives to a reasonable level. During 2020-21, there have been a small number of areas where controls have been adapted as a result of covid-19. However, these changes have not undermined the effectiveness of the control environment and nothing has come to light in 2020-21 to materially impact on this opinion.</p> <p>No risk areas have been identified in relation to the financial statements.</p> <p>Roles and responsibilities in relation to systems of control are defined in various places such as the Constitution and Contract Procedure Rules and are enforced as far as practicable through ICT system controls and monitoring. This includes controls enforced through the Agresso system, which limits the potential for override of controls over the financial reporting process. Service area controls , e.g segregation of duties of officers to mitigate fraud are in place to support the Councils Fraud and Corruption Strategy and Whistleblowing Policy.</p>
<p>7. Are there any areas where there is potential for misreporting?</p>	<p>None known.</p>

# Fraud risk assessment

Question	Management response
<p>8. How does Coventry City Council communicate and encourage ethical behaviours and business processes of its staff and contractors?</p> <p>How do you encourage staff to report their concerns about fraud?</p> <p>What concerns are staff expected to report about fraud?</p> <p>Have any significant issues been reported?</p>	<p>The Council has a Code of Conduct which sets out the expected behaviours of its staff. In addition, all staff and agency workers are required to undergo an induction process. Contracts include terms and conditions around the behaviours etc of contractors. Policies linked to ethical behaviour and business processes are available on the Council's Intranet site and highlighted in the Managers Talk monthly emails.</p> <p>The Council has a Fraud and corruption Strategy, a Whistleblowing Policy and an e-learning fraud awareness tool in place. Other mechanisms are also used to encourage staff to report concerns, including the Finance and Audit school newsletter and face to face fraud awareness sessions. Staff are expected to raise all concerns about fraud with the Chief Internal Auditor. In 2020/21 to date, one significant fraud has been identified which has been subject to a formal report to Audit and Procurement Committee. This has not materially impacted on the accuracy of the financial statements. One issue relating to a cash discrepancy is being investigated but is not of material value in relation to the financial statements.</p>
<p>9. From a fraud and corruption perspective, what are considered to be high-risk posts?</p> <p>How are the risks relating to these posts identified, assessed and managed?</p>	<p>Any postholder with responsibilities for handling income, particularly cash, or who have budget holder responsibilities could be considered to be high-risk. However, levels of cash income are not significant and appropriate checks and balances are in place, including budget monitoring, scheme of delegation and segregation of duties, which are also enforced through the Agresso system.</p>

# Fraud risk assessment

Question	Management response
<p>10. Are you aware of any related party relationships or transactions that could give rise to instances of fraud?</p> <p>How do you mitigate the risks associated with fraud related to related party relationships and transactions?</p>	<p>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 Councillor's declaration of interests and non-participation in debates.</p> <p>All postholders grade 9 and above are required to complete an annual declaration of interests and provide details of how any potential conflicts of interests are managed.</p> <p>In addition, the Council receives and reviews data matches via the National Fraud Initiative linked to this area of risk.</p>
<p>11. What arrangements are in place to report fraud issues and risks to the Audit &amp; Procurement Committee?</p> <p>How does the Audit &amp; Procurement Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control?</p> <p>What has been the outcome of these arrangements so far this year?</p>	<p>The Audit and Procurement Committee receive half yearly reports on anti fraud and corruption activity.</p> <p>The Committee also receive quarterly Internal Audit progress reports which provides details of key audits undertaken. Where appropriate this would include issues relating to management processes for mitigating the risk of fraud and internal control issues.</p> <p>The Chief Internal Auditor's annual audit opinion on the adequacy and effectiveness of the internal control environment also highlights any significant control issues to the Committee.</p> <p>In 2020-21, details of actions taken by Internal Audit in-conjunction with service areas to manage the risk of fraud in covid-19 business grant schemes have also been provided to the Committee .</p>

# Fraud risk assessment

Question	Management response
12. Are you aware of any whistle blowing potential or complaints by potential whistle blowers? If so, what has been your response?	The Council has a Whistleblowing Policy and a defined process in place to deal with concerns raised by whistle blowers. In 2020/21, four complaints linked to potential fraud have been raised. None of the cases were substantiated. None of the complaints relates to misstatement within the financial statements / financial reporting due to fraud.
13. Have any reports been made under the Bribery Act?	Two of the complaints referred to in Q12 above related to potential bribery offences. Both related to minor incidents linked to operational activity in service areas and were not substantiated.

# Law and regulations

## Issue

### **Matters in relation to laws and regulations**

ISA (UK) 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 & Procurement Committee, is responsible for ensuring that Coventry City 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 & 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 below together with responses from management.

# Impact of laws and regulations

Question	Management response
<p>1. How does management gain assurance that all relevant laws and regulations have been complied with?</p> <p>What arrangements does Coventry City Council have in place to prevent and detect non-compliance with laws and regulations?</p> <p>Are you aware of any changes to the Authority's regulatory environment that may have a significant impact on the Authority's financial statements?</p>	<p>Service managers are responsible for ensuring that laws and regulations relevant to their services are observed including any changes to the regulatory environment. 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. The Council also operates a range of supporting mechanisms including management teams, internal audit and the Corporate Governance Group. We are not aware of any changes to the regulatory environment which will have a significant impact on the Council's financial statements. As part of the annual review of effectiveness which underpins the Annual Governance Statement, all Directors are asked to complete a statement of assurance. This includes confirming that there have been no significant breaches of laws and regulations within their service areas in the past year.</p>
<p>2. How is the Audit &amp; Procurement Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<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

Question	Management response
3. Have there been any instances of non-compliance or suspected non-compliance with laws and regulation since 1 April 2020 with an on-going impact on the 2020/21 financial statements?	No.
4. Is there any actual or potential litigation or claims that would affect the financial statements?	No.
5. What arrangements does Coventry City Council have in place to identify, evaluate and account for litigation or claims?	A consultation is undertaken with the Director of Legal and Governance (the Council's Monitoring Officer) to identify any significant litigation claims at the year end.
6. Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	There have been no reports of non-compliance from regulatory bodies.

# Related Parties

## Issue

### Matters in relation to Related Parties

Coventry City Council is required to 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 Coventry City Council;
- 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.

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 Authority must disclose it.

ISA (UK) 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 Parties

Question	Management response
<p>1. Have there been any changes in the related parties including those disclosed in Coventry City Council's 2019/20 financial statements?</p> <p>If so please summarise:</p> <ul style="list-style-type: none"><li>• the nature of the relationship between these related parties and Coventry City Council</li><li>• whether Coventry City Council has entered into or plans to enter into any transactions with these related parties</li><li>• the type and purpose of these transactions</li></ul>	<p>Any new related parties will be identified through the preparation of the Council's year-end accounts. No changes have been identified at this stage.</p>
<p>2. What controls does Coventry City Council have in place to identify, account for and disclose related party transactions and relationships?</p>	<p>Related party transactions and relationships are reported within the statutory accounting process through analysis of existing disclosure records and a process to collect information on these relationships. Controls include an annual exercise whereby all postholders grade 9 and above are required to declare any interests they hold including relationships to related parties.</p>

# Related Parties

Question	Management response
3. What controls are in place to authorise and approve significant transactions and arrangements with related parties?	Transactions with related parties are subject to the same authorisation and approval arrangements as other transactions including controls enforced through the Agresso system and the observance of the segregation of duties of officers. Significant changes to arrangements with related parties will be reported through the Council's political management processes as appropriate.
4. What controls are in place to authorise and approve significant transactions outside of the normal course of business?	All transactions including any outside the normal course of business are subject to the same authorisation and approval arrangements including controls enforced through the Agresso system and the observance of the segregation of duties of officers. All business will be expected to be within Council policy and any new business will be subject to a formal decision through political management arrangements

# Accounting estimates

## Issue

### Matters in relation to Related Accounting estimates

ISA (UK) 540 (Revised December 2018) requires auditors to understand and assess an entity's internal controls over accounting estimates, including:

- The nature and extent of oversight and governance over management's financial reporting process relevant to accounting estimates;
- How management identifies the need for and applies specialised skills or knowledge related to accounting estimates;
- How the entity's risk management process identifies and addresses risks relating to accounting estimates;
- The entity's information system as it relates to accounting estimates;
- The entity's control activities in relation to accounting estimates; and
- How management reviews the outcomes of previous accounting estimates.

As part of this process auditors also need to obtain an understanding of the role of those charged with governance, which is particularly important where the estimates have high estimation uncertainty, or require significant judgement.

Specifically do Audit & Procurement Committee members:

- Understand the characteristics of the methods and models used to make the accounting estimates and the risks related to them;
- Oversee management's process for making accounting estimates, including the use of models, and the monitoring activities undertaken by management; and
- Evaluate how management made the accounting estimates?

We would ask the Audit & Procurement Committee to satisfy itself that the arrangements for accounting estimates are adequate.

# Accounting Estimates - General Enquiries of Management

Question	Management response
<p>1. What are the classes of transactions, events and conditions, that are significant to the financial statements that give rise to the need for, or changes in, accounting estimate and related disclosures?</p>	<p>The need for material accounting estimates is considered for property asset valuations, pensions assets and liabilities values, the fair value of long-term investments and provision for credit losses and impairment allowances and provision for other liabilities.</p>
<p>2. How does the Authority's risk management process identify and addresses risks relating to accounting estimates?</p>	<p>Each area is subject to robust scrutiny as part of the closedown process informed by input from external professional experts where appropriate and using evidence based approaches to assess the estimation basis. This is set out in detail in the separate response requested.</p>
<p>3. How does management identify the methods, assumptions or source data, and the need for changes in them, in relation to key accounting estimates?</p>	<p>Each area has a clear set of base information and/or accounting records including a significant degree of historical data where relevant. They will have established calculation bases which are reviewed and refined in response to external challenge (e.g. from the external auditor) or changing circumstances (e.g. the Covid pandemic).</p>
<p>4. How does management review the outcomes of previous accounting estimates?</p>	<p>Accounting estimates will be reviewed as the natural course of some of these estimates where historical data/performance provides the starting point of estimation. Other areas of estimation are subject to valuation from first principles each year.</p>
<p>5. Were any changes made to the estimation processes in 2020/21 and, if so, what was the reason for these?</p>	<p>The Council has engaged external valuation expertise in relation to long-term investments and property valuations to increase the degree of independent challenge. The impact of COVID-19 will be a significant factor in estimation processes although no processes have changed specifically in response to the pandemic.</p>

# Accounting Estimates - General Enquiries of Management

Question	Management response
6. How does management identify the need for and apply specialised skills or knowledge related to accounting estimates?	Differentiation has been made between where external expert knowledge and access to wider market data is required to make an accounting estimate and where in-house expertise and experience can be reasonably applied. There is a value for money consideration in respect of the likely value and variability of accounting estimates and the cost of procuring external advice.
7. How does the Authority determine what control activities are needed for significant accounting estimates, including the controls at any service providers or management experts?	There is a degree of reliance on the work of externally procured experts although all accounting estimated will be subject to a test of reasonableness. Actuarial and property valuation experts work within industry wide standards which provide a high degree of quality assurance.
8. How does management monitor the operation of control activities related to accounting estimates, including the key controls at any service providers or management experts?	External experts provide comprehensive reports detailing the basis and output of their work which provides management the facility to understand and challenge accounting estimates.
9. What is the nature and extent of oversight and governance over management's financial reporting process relevant to accounting estimates, including: <ul data-bbox="117 779 672 918" style="list-style-type: none"><li>- Management's process for making significant accounting estimates</li><li>- The methods and models used</li><li>- The resultant accounting estimates included in the financial statements.</li></ul>	Areas of significant accounting estimates are clearly flagged in the financial reporting process to the Council's Audit and Procurement Committee through the note on 'Significant Assumptions made in estimating Assets and Liabilities'. Areas of volatility and those deemed to be of significant interest (by value or nature) will be given particular prominence in the presentation to Committee.

# Accounting Estimates - General Enquiries of Management

Question	Management response
10. Is management aware of transactions, events, conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgement?	The Covid pandemic has changed the conditions under which many significant accounting estimates are undertaken and which may require significant judgement. The detailed exercise in each area will determine the degree to which such judgement is required.
11. Are the management arrangements for the accounting estimates reasonable?	Yes, detailed arrangements are in place.
12. How is the Audit & Procurement Committee provided with assurance that the arrangements for accounting estimates are adequate ?	See question 9. The Audit and Procurement Committee are informed of the arrangements in place for areas that are subject to significant accounting estimates.



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