



Informing the audit risk assessment for Merseyside Fire & Rescue Authority

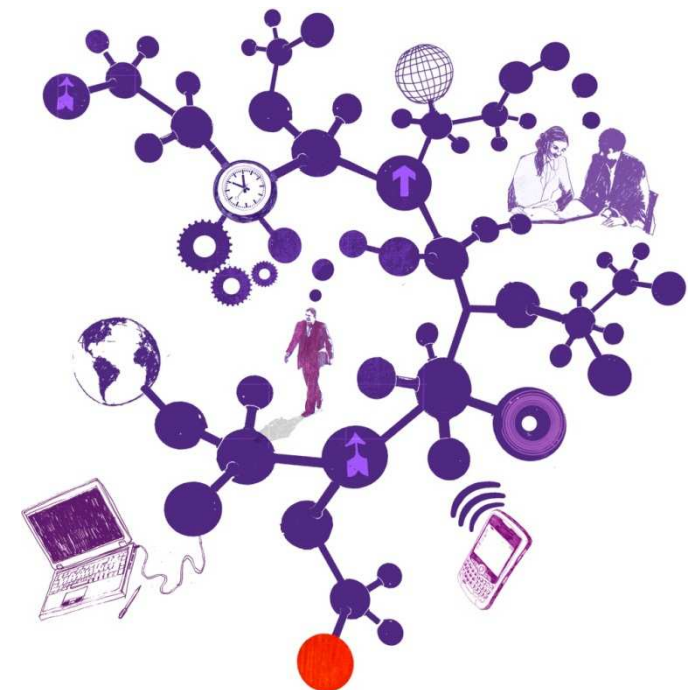
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Purpose

The purpose of this report is to contribute towards the effective two-way communication between auditors and the Authority as 'those charged with governance'. The report covers some important areas of the auditor risk assessment where we are required to make inquiries of Management and the Authority under auditing standards.

Background

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

This two-way communication assists both the auditor and the Authority 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 Authority, and supports the Authority 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 oversight of the following areas:

- fraud
- laws and regulations
- financial reporting and going concern.

This report includes a series of questions on each of these areas.

Fraud

Issue

Matters in relation to fraud

ISA(UK&I)240 covers auditors responsibilities relating to fraud in an audit of financial statements.

The primary responsibility to prevent and detect fraud rests with both the Authority and management. Management, with the oversight of the Authority, 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 Authority should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error. We are required to maintain professional scepticism throughout the audit, considering the potential for management override of controls.

As part of our audit risk assessment procedures we are required to consider risks of fraud. This includes considering the arrangements management has put in place with regard to fraud risks including:

- assessment that the financial statements could be materially misstated due to fraud
- process for identifying and responding to risks of fraud, including any identified specific risks
- communication with the Authority 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 Authority oversees the above processes. We are also required to make inquiries of both management and the Authority as to their knowledge of any actual, suspected or alleged fraud. These areas have been set out in the fraud risk assessment questions below.

Fraud risk assessment

| Question | Management response / Those charged with governance additional comments |
|---|--|
| <p>Has the Authority assessed the risk of material misstatement in the financial statements due to fraud?</p> <p>What are the results of this process?</p> | <p>The Authority has a zero-tolerance approach towards fraud and has a comprehensive counter-fraud culture, policies and procedures in place:</p> <p>A code of corporate governance</p> |
| <p>What processes does the Authority have in place to identify and respond to risks of fraud?</p> | <p>Annually Financial Regulations, Standing Orders & Scheme of Delegation</p> <p>Anti Fraud & Corruption Policy & Strategy</p> <p>Fraud Response Plan</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>What have you determined to be the classes of accounts, transactions and disclosures in the financial statements that are most at risk of fraud?</p> | <p>Confidential Reporting Policy</p> <p>Procurement Strategy</p> <p>New Recruit Control Checklist</p> <p>New Recruit Probationary review procedure</p> <p>Code of Conduct for staff (includes emphasis on fraud)</p> <p>Bi-annual fraud awareness notification to all staff via payroll slip</p> |
| <p>Are internal controls, including segregation of duties, in place and operating effectively?</p> <p>If not, where are the risk areas and what mitigating actions have been taken?</p> | <p>Annual Governance Statement to members – a review of the governance framework that comprises the systems, processes, culture, values and system of internal control that manage the risks the Authority faces.</p> <p>Internal Audit plan to review the internal control system.</p> <p>The Authority does not have responsibility for Housing Benefit or other social & welfare payments, the Audit Commission's had identified these areas as having significant risk of fraud. Approximately 70% of the Authority's spend is employee related and 10% related to the servicing of capital debt and therefore the potential for fraud is more restricted within MFRA.</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 Finance Department employ suitably qualified professionals to prepare the financial statements, and these staff on provided with substantive training to ensure any new standards are followed. This significantly reduces the risk of error in the financial statements. Comprehensive quarterly financial review reports are produced for Management & members, any variances to the approved financial plan will be reported.</p> |

Fraud risk assessment

| Question | Management response / Those charged with governance additional comments |
|---|---|
| <p>How does the Authority exercise oversight of management's processes for identifying and responding to risks of fraud?</p> <p>What arrangements are in place to report fraud issues and risks to the Audit Committee?</p> | <p>The Audit Sub Committee receive copies of all internal audit reports and investigations. If any fraud was discovered the Audit Sub Committee would receive a comprehensive report and have an opportunity to discuss the matter.</p> |
| <p>How does the Authority communicate and encourage ethical behaviour of its staff and contractors?</p> | <p>Staff; Code of conduct – Value based appraisal process. Contractors; Procurement stipulate conditions within Standing Orders / Contract documentation</p> |
| <p>How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?</p> <p>Have any reports been made under the Bribery Act?</p> | <p>Bi-annual notification to staff of confidential / fraud awareness policy via a message on payslips.</p> <p>No reports have been made under the Bribery Act.</p> |
| <p>Are you aware of any related party relationships or transactions that could give rise to risks of fraud?</p> | <p>No. In recent years the Legal Team provided specific training to senior staff on the acceptance of gifts and hospitality. The ACE and Director of Legal Services meet regularly to review the Gifts and Hospitality register.</p> |
| <p>Are you aware of any instances of actual, suspected or alleged, fraud, either within the Authority as a whole or within specific departments since 1 April 2016?</p> | <p>No. The Service has established a Professional Standards Team who deal with any potential fraud allegations.</p> |
| <p>Have any of the Authority's service providers reported any items of fraud, non-compliance with laws and regulations or uncorrected misstatements which could affect the financial statements?</p> | <p>No reports of fraud have been made.</p> |

Laws and regulations

Issue

Matters in relation to laws and regulations

ISA(UK&I)250 requires us to consider the impact of laws and regulations in an audit of the financial statements.

Management, with the oversight of the Authority, is responsible for ensuring that the Authority's operations are conducted in accordance with laws and regulations including those that determine amounts in the financial statements.

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

Impact of Laws and regulations

| Question | Management response / Those charged with governance additional comments |
|---|---|
| What arrangements does the Authority have in place to prevent and detect non-compliance with laws and regulations? | As well as the policies and procedures outlined in the Fraud section, the Authority employs a qualified solicitor who fulfils the statutory Monitoring Officer role, who is supported by an experienced legal team to ensure all decisions are legal and regulations are complied with. Counsel advice and support is sought as and when required. |
| How does management gain assurance that all relevant laws and regulations have been complied with? | Use of the Authority's solicitor and counsel advice as required. |
| How is the Authority provided with assurance that all relevant laws and regulations have been complied with? | See above and an Authority solicitor is present at all committee meetings |
| Have there been any instances of non-compliance or suspected non-compliance with law and regulation since 1 April 2016, or earlier with an on-going impact on the 2016/17 financial statements? | No instances of non-compliance or suspected non-compliance with law and regulation |
| What arrangements does the Authority have in place to identify, evaluate and account for litigation or claims? | Authority employs a qualified solicitor who is supported by an experienced legal team. Any liable claim is met from a specific insurance policy or internal fund. Legal work with Finance to ensure all claims are provided for. |
| Is there any actual or potential litigation or claims that would affect the financial statements? | No, see previous comment. At the end of each year all outstanding claims are reviewed and if necessary reserves or provisions established to cover any potential settlement. |
| Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance? | No reports from other regulatory bodies that indicate non-compliance. |

Financial Reporting and Going Concern

Issue

Matters in relation to financial reporting and 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 Authority 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 Authority's financial resilience.

Financial reporting and going concern considerations have been set out below.

Financial Reporting Considerations

| Question | Management response/ Those charged with governance additional comments |
|---|--|
| What has the Authority identified as the key events or issues that will have a significant impact on the financial statements for 2016/17? | No material change from 2015/16 SORP therefore continue with same approach as previous years in terms of preparation of Statements. Although it has no impact on the Authority's true financial position any adjustments to the existing pension accounts as a consequence of the latest valuations will be reflected in the financial statements. |
| How do the Authority's risk management processes link to financial reporting? | Consider financial implications of identified risks in the risk register and if necessary create reserves to cover risk. If risk results in a permanent costs then re-align the budget. |
| Has the Authority considered the appropriateness of the accounting policies adopted? Have there been any events or transactions that may cause the Authority to change or adopt new accounting policies? | Accounting policies reflect best practice and guidelines. No events have arisen to require revision to current policies. |
| Have there been any changes to the Authority's regulatory environment that may have a significant impact on the financial statements? | No changes to the Authority's regulatory environment |
| Have there been any significant transactions outside the normal course of business? | No significant transactions outside the normal course of business. |
| Is the Authority aware of any changes in circumstances that would lead to impairment of non-current assets? | No changes in circumstances that would lead to impairment of non-current assets. |
| Is the Authority aware of any new transactions, events and conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgement? | No new transactions, events and conditions that require significant judgement. |

Going Concern Considerations

| Question | Management response/ Those charged with governance additional comments |
|--|--|
| Does the Authority have procedures in place to assess the Authority's ability to continue as a going concern? | The Authority maintains a rolling 5 year financial plan in order to ensure it has sufficient financial resources to continue for the foreseeable future, this includes the establishment of a level of reserves to provide a contingency in case of unforeseen events and provide sufficient time for the service to re-engineer itself in light of the anticipated financial challenge ahead. The service also prepares a 3 year IRMP plan to constantly assess and re-engineer its service priorities. |
| Is 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? | No doubt on the Authority's ability to continue as a going concern. |
| Are arrangements in place to report the going concern assessment to the Authority? | Regular reviews of the financial plan & IRMP are carried out throughout the year and reported to the relevant committees. |
| Are the financial assumptions supporting the going concern assessment (i.e. future levels of income and expenditure) consistent with the Authority's Plans and the financial information provided to the Authority throughout the year? | Yes, the 5 year financial plan, annual budget, and IRMP are considered at the Budget Authority meeting. |
| Are the implications of statutory or policy changes appropriately reflected in the Authority's Plans, financial forecasts and report on going concern? | Yes, the main issue is how the service meets the financial challenge while maintaining its statutory responsibilities. See previous comment on 5 year plan |
| Have there been any significant issues raised with the Authority 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 significant issues raised with the Authority during the year which could cast doubts on the assumptions made. |

Going Concern Considerations

| Question | Management response/ Those charged with governance additional comments |
|---|---|
| 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 negative cash flows |
| 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 there are appropriate skills in place. |



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