

Informing the audit risk assessment for Somerset County Council and Pension Fund - 2019/20



The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect your business or any weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

Table of Contents

Section	Page
Purpose	4
General Enquiries of Management	6
Fraud	7
Fraud Risk Assessment	8
Laws and Regulations	13
Impact of Laws and Regulations	14
Going Concern	16
Going Concern Considerations	17
Related Parties	21
Accounting Estimates	23
Appendix A Accounting Estimates	25

Purpose

The purpose of this report is to contribute towards the effective two-way communication between Somerset County Council and Pension Fund's (The Council and Pension Fund) external auditors and the Council's Audit 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 Committee under auditing standards.

Background

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

This two-way communication assists both the auditor and the Audit 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 Committee and supports the 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 Council and Pension Fund's oversight of the following areas:

- General Enquiries of Management
- Fraud,
- Laws and Regulations,
- Going Concern,
- 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 the Council's management. The Audit 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 2019/20?	The impact of COVID-19 and the associated funding, service delivery/demand pressures and valuation issues.
2. Have you considered the appropriateness of the accounting policies adopted by the Council and Pension Fund? Have there been any events or transactions that may cause you to change or adopt new accounting policies?	In light of the annual revisions to the CIPFA Code of Practice and other “best practice” guidance, we continually review our accounting policies and consider how they affect the Council’s and Pension Fund Accounts. Compliance with the CIPFA Code will mean that we use appropriate accounting policies. In addition, we continually assess the Group Accounts boundary in the light of prevalent guidance and to accommodate any changes to governance arrangements at the County Council through a flowcharting process.
3. Is there any use of financial instruments, including derivatives?	All financial instruments are disclosed in our notes to the accounts within our Statement of Accounts. During 2018/19 we invested a further £5m in the CCLA Property Fund (bringing our total investment in the Fund to £15m) and the investment in this fund will be disclosed within the Statement of Accounts. There is no use derivatives by SCC.
4. Are you aware of any significant transaction outside the normal course of business?	No

General Enquiries of Management

Question	Management response
5. Are you aware of any changes in circumstances that would lead to impairment of non-current assets?	<p>An assessment is made annually by our valuers of our non-current assets and whether any impairment has occurred in the year.</p> <p>The impact of COVID-19 has clearly brought with it some uncertainties. We have opened dialogue with Grant Thornton to agree on the best way to consider any potential impairments given these unprecedented times.</p>
6. Are you aware of any guarantee contracts?	Guarantee bonds that are in place have been assessed as not material.
7. Are you aware of the existence of loss contingencies and/or un-asserted claims that may affect the financial statements?	Yes, we are aware of all outstanding legal cases which are assessed for any loss contingencies as part of our Statement of Accounts processes.
8. Other than in house solicitors, can you provide details of those solicitors utilised by the Council and Pension Fund during the year. Please indicate where they are working on open litigation or contingencies from prior years?	Legal Services on behalf of SCC have instructed DAC Beachcroft, Michelmores, Foot Anstey, Mendip District Council, Carbon Law Partnership and DWF in 2019/20. None of these instructions relate to litigation from prior years.
9. Have any of the Council or Pension Fund'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 council has regularly used advisors / consultants across various services on a range of issues to provide expert advice. For finance, we use advice for various specialisms such as specific VAT advice, insurance brokers, treasury advisors and LG Futures for financial forecasting & modelling. If there is a particular area that further details are required this can be provided.

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 Committee and management. Management, with the oversight of the Audit 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 Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As the Council and Pension Fund'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 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 Committee oversees the above processes. We are also required to make inquiries of both management and the Audit 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>1. Have the Council and Pension Fund 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 Council and Pension Fund's risk management processes link to financial reporting?</p>	<p>We do not believe this to be an issue as no material frauds have been identified during the year. We believe that the risk of unknown material fraud to be low.</p> <p>Our control environment around fraud control has not changed from previous years. A key part of our arrangements is the use SWAP Ltd as our Internal auditors. Their processes have not identified any frauds during 2019/20.</p> <p>There is robust medium term financial plan in place to ensure a sound budget is set for the year. Comprehensive monthly budget monitoring ensures the risks of over or underspending are well managed and projects remain on track. Budget monitoring is part of the overall system of internal controls designed to mitigate against risks of incorrect financial reporting.</p>
<p>2. What have you determined to be the classes of accounts, transactions and disclosures most at risk to fraud?</p>	<p>Account payable and payroll</p>
<p>3. Are you aware of any instances of actual, suspected or alleged fraud, errors or other irregularities either within the Council and Pension Fund as a whole or within specific departments since 1 April 2019? As a management team, how do you communicate risk issues (including fraud) to those charged with governance?</p>	<p>No instances of fraud since 1 April 2019.</p> <p>Regular risk updates are presented to the Audit Committee and each January an Anti-Fraud and Corruption Paper is also presented to this committee. This paper includes a summary of actual, suspected and alleged frauds over the previous year.</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 the Council where fraud is more likely to occur?</p>	<p>Areas at risk of fraud are identified by:</p> <ul style="list-style-type: none"> • CIPFA fraud survey • SWAP audit work • Staff allegations • Risk register/assessments
<p>5. What processes do the Council and Pension Fund have in place to identify and respond to risks of fraud?</p>	<p>Identification through:</p> <ul style="list-style-type: none"> • National Commentaries including CIPFA • NFI work • SWAP Audit work – fraud is considered when scoping audit work, annually financial audits undertaken and fraud related themed audits undertaken. <p>Response:</p> <ul style="list-style-type: none"> • SWAP trained auditors investigate allegations as they arise.
<p>6. How would you assess the overall control environment for the Council and Pension Fund, including: the process for reviewing the effectiveness the system of internal control; internal controls, including segregation of duties; exist and work effectively?</p> <p>If not 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>Received a reasonable opinion for the overall adequacy and effectiveness of SCC's governance, risk management and internal control environment. This includes the potential for the occurrence of fraud and how the Council manages fraud risk.</p> <p>Fraud and Corruption Policy that is annually reviewed by Audit Committee</p> <p>No</p>

Fraud risk assessment

Question	Management response
7. Are there any areas where there is potential for misreporting?	There is always going to be some risk of this but we believe it is very small given the overall control environment.
<p>8. How do the Council and Pension Fund communicate and encourage ethical behaviours and business processes of it's 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? Have any significant issues been reported?</p>	<p>Through the use of CORE brief, staff induction & training. All outside organisations contracted are bound by strict ethical behaviours contained within their contract.</p> <p>Reporting procedures laid out in Anti-Fraud and Corruption Policy. Also through the Council's whistleblowing policy.</p> <p>Staff must report any concerns they may have regarding fraud and corruption, whether it relates to dishonest behaviours by Council employees, Members, Contractors or by others. No significant issues have been reported during the financial year 2019/20.</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>	Because of the overall governance framework and internal control environment there are no posts that are considered to be high-risk.
<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>All elected members and senior officers are required to provide details of any related party relationships on an annual basis.</p> <p>SCC staff are bound by the Council's Contract Standing Orders to ensure proper procurement practices are followed at all times.</p>

Fraud risk assessment

Question	Management response
<p>11. What arrangements are in place to report fraud issues and risks to the Audit Committee? How does the Audit Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control? What has been the outcome of these arrangements so far this year?</p>	<p>The Anti-Fraud and Corruption Policy sets out the ways to report and investigate fraud. These are all reported to Audit Committee through SWAP Ltd.</p> <p>No instances of fraud have been reported in 2019/20.</p>
<p>12. Are you aware of any whistle blowing potential or complaints by potential whistle blowers? If so, what has been your response?</p>	<p>No</p>
<p>13. Have any reports been made under the Bribery Act?</p>	<p>No</p>

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 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 auditors, 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 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 do the Council and Pension Fund have in place to prevent and detect non-compliance with laws and regulations?</p> <p>Are you aware of any changes to the Council or Pension Fund regulatory environment that may have a significant impact on the financial statements?</p>	<p>Somerset County Council's constitution and scheme of delegation outlines the rights, responsibilities and duties of the Council and its officers. The Monitoring Officer oversees compliance with the constitution and scheme of delegation, and reports on matters he believes are or are likely to be illegal or amount to maladministration. The Monitoring Officer seeks legal advice should he require it, additionally he checks that Legal Services are consulted as part of any decision making process</p>
<p>2. How is the Audit Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>All committee report require sign off by statutory officers and other key officers and there is a clear section on legislation</p>
<p>3. Have there been any instances of non-compliance or suspected non-compliance with laws and regulation since 1 April 2019 with an on-going impact on the 2019/2020 financial statements?</p>	<p>No</p>
<p>4. Is there any actual or potential litigation or claims that would affect the financial statements?</p>	<p>Legal Services have 2 pieces of litigation outstanding which may affect the financial statements. One relates to claims against a builder in relation to 5 children's centres, one of which has already been re-built and the second piece of litigation is a Land Tribunal claim based upon a compulsory purchase order. A sum of money has already been paid to the claimant which SCC believes amounts to 90% of the value however the claimant seeks an additional sum approximately twice the value already paid.</p>

Impact of laws and regulations

Question	Management response
5. What arrangements do the Council and Pension Fund have in place to identify, evaluate and account for litigation or claims?	Generally speaking within Legal Services, we are instigating claims rather than defending them. Claims are assessed on an individual basis as they are known.
6. Have there been any report from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	No

Going Concern

Issue

Matters in relation to going concern

ISA (UK) 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.

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

Going concern considerations

Question	Management response
<p>1. Has the management team carried out an assessment of the going concern basis for preparing the financial statements for Somerset County Council? What was the outcome of that assessment?</p>	<p>The 2019/20 CIPFA Code of Practice (paragraph 2.1.2.9) sets out the “underlying assumption” around going concern, namely that “an authority’s financial statements shall be prepared on a going concern basis; that is, the accounts should be prepared on the assumption that the functions of the authority will continue in operational existence for the foreseeable future”.</p> <p>There are, to our knowledge, no proposed changes to the “machinery of government” that would necessitate a change to the financial Statements, and even if that were to be a change, the Code confirms that “Transfers of services under combinations of public sector bodies (such as local government reorganisation) do not negate the presumption of going concern”.</p>
<p>2. Are the financial assumptions in that report (e.g., future levels of income and expenditure) consistent with the Council’s Medium Term Financial Plan and the financial information provided to the Audit Committee throughout the year?</p>	<p>Yes</p>

Going concern considerations

Question	Management response
3. Are the implications of statutory or policy changes appropriately reflected in the Medium Term Financial Plan, financial forecasts and report on going concern?	Yes
4. Have there been any significant issues raised with the Audit 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
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? If so, what action is being taken to improve financial performance?	No

Going concern considerations

Question	Management response
6. 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?	Yes
7. Does the Council have procedures in place to assess their ability to continue as a going concern?	Yes
8. Is management aware of the existence of events or conditions that may cast doubt on the Council's ability to continue as a going concern?	No

Going concern considerations

Question	Management response
<p>9. Are arrangements in place to report the going concern assessment to the Audit Committee ?</p> <p>How has the Audit Committee satisfied itself that it is appropriate to adopt the going concern basis in preparing financial statements?</p>	<p>The 2019/20 CIPFA Code of Practice (paragraph 2.1.2.9) sets out the “underlying assumption” around going concern, namely that “an authority’s financial statements shall be prepared on a going concern basis; that is, the accounts should be prepared on the assumption that the functions of the authority will continue in operational existence for the foreseeable future”.</p> <p>There are, to our knowledge, no proposed changes to the “machinery of government” that would necessitate a change to the financial Statements, and even if that were to be a change, the Code confirms that “Transfers of services under combinations of public sector bodies (such as local government reorganisation) do not negate the presumption of going concern”.</p>

Related Parties

Issue

Matters in relation to Related Parties

Somerset County Council and Somerset Pension Fund are required to comply with IAS 24 and disclose transactions with entities/individuals that would be classed as related parties. These may include:

- entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the Council
- associates;
- 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 perspective but material from a related party viewpoint then Council 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. What controls do the Council and Pension Fund have in place to identify, account for and disclose related party transactions and relationships ?</p>	<p>The authorities elected Members are sent an annual questionnaire to identify any material related party transactions, and the findings from the responses are disclosed in the published accounts.</p> <p>The authority reviews existing contractual arrangements to determine whether the authority has significant influence over the other parties due to the considerable proportion of business provided to them by the authority. Any material findings are disclosed in the published accounts.</p>

Accounting estimates

Issue

Matters in relation to Related Accounting estimates

Somerset County Council apply appropriate estimates in the preparation of their financial statements. ISA (UK) 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 Combined 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 estimates that the Combined Council is using as part of its accounts preparation; these are detailed in appendix 1 to this report. The audit procedures we conduct on the accounting estimate will demonstrate that:

- the estimate is reasonable; and
- estimates have been calculated consistently with other accounting estimates within the financial statements.

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

Accounting Estimates

Question	Management response
1. Are 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 (other than those in Appendix A)?	Disclosure of existing critical judgements is made within the notes to the accounts within our Statement of Accounts. The impact of COVID-19 will give rise to further disclosure this year, given the level of material uncertainty.
2. Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable?	Yes, where the authority does not have the in-house knowledge to form a reasonable assessment, suitably experienced external professionals are commissioned to assist with the assessment.
3. How is the Audit Committee provided with assurance that the arrangements for accounting estimates are adequate ?	Appropriately qualified staff and advisors are used for providing 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, plant & equipment Valuations	Current value for land/buildings at depreciated replacement cost/existing use value/fair value	Valuations are performed on a 5 year cyclical basis to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.	Yes	Degree of uncertainty inherent with any revaluation. We employ professional valuers and rely on expert opinion.	No
Estimated remaining useful lives of PPE	Each part of an item of property, plant and equipment with a significant cost in relation to the total cost is depreciated separately. Depreciation methods, useful lives and residual values are reviewed each financial year and adjusted if appropriate.	See left box	Discussion with the Estates team	Depreciation is calculated on a straight line basis as this reflects consumption of assets and is a reasonable assumption.	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?
Depreciation and Amortisation	See above	See above	See above	See above	No
Impairments	Review of all assets undertaken annually	See left.	Discussion with internal asset team as appropriate.	N/A.	No.
Measurement of Financial Instruments	Financial instruments consist of investments and loans. Measured initially at cost and subsequently at amortised cost using the effective interest method.	Knowledge by the Investment team who manages the portfolio in assessing the potential risk in credit losses.	Fund advisers – Arlingclose	The assumptions used are undertaken by Arlingclose as part of the fair value measurement of financial instruments	No

Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Provisions for liabilities	Provisions are identified through detailed monthly management accounts which flags any potential issues to management.	Each provision is separately reviewed by financial accounts and a working is put together to support the calculation.	As necessary on an individual basis	Each provision is assessed on an individual basis to ensure that it meets the criteria of a provision per IAS 37. The degree of uncertainty is assessed when determining whether a provision is the correct treatment for an item.	No.
Bad Debt Provision	Debts are reviewed monthly and any debts that are deemed to be irrecoverable are provided for	Knowledge by the Accounts Receivables team in likelihood of recoverability and the aging of the debts.	N/A	N/A	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?
Accruals	The Council use standard accruals accounting –accruals are based on expenses incurred that have not yet been paid.	Monthly management accounts provides rigorous analysis so that any accruals are highlighted and actioned throughout the year.	N/A.	N/A.	No.
Non Adjusting events – events after the balance sheet date	Monthly management accounts prepared would flag any adjusting/non-adjusting events.	See left.	N/A.	N/A.	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 (LGPS) Actuarial gains/losses	The actuarial gains and losses figures are calculated by the actuarial expert Barnett Waddingham. These figures are based on making % adjustments to the closing values of assets/liabilities.	The Council responds to queries raised by the administering body, Somerset Pension Fund.	The Council are provided with an actuarial report by Hymans Roberson (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.



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