

# Informing the audit risk assessment for Eastern Shires Purchasing Organisation (ESPO) 2019/20

**John Gregory**  
Director  
E [john.gregory@uk.gt.com](mailto:john.gregory@uk.gt.com)



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## Purpose

The purpose of this report is to contribute towards the effective two-way communication between ESPO's external auditors and ESPO's Management 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 Management Committee under auditing standards.

## Background

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

This two-way communication assists both the auditor and the Management 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 Management Committee and supports the Management 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 ESPO'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 ESPO's management. The Management 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
<p>1. What do you regard as the key events or issues that will have a significant impact on the financial statements for 2019/20?</p>	<p>Transition from CIPFA, to preparing our financial statements under FRS102. There will therefore be a restatement of the prior year balance sheet under FRS102 included within this year's financial statements.</p> <p>The effects of Covid 19 – this has impacted our sales at very end of the year, due to drop off in demand with uncertainty around schools closing.</p>
<p>2. Have you considered the appropriateness of the accounting policies adopted by ESPO? Have there been any events or transactions that may cause you to change or adopt new accounting policies?</p>	<p>Transition from CIPFA to prepare our financial statements under FRS102 may cause some change to accounting policies, however nothing significant has been noted so far.</p>
<p>3. Is there any use of financial instruments, including derivatives?</p>	<p>Financial Instruments that ESPO use are loans, receivables and borrowings and have fixed or determinable payments. These are not quoted in an active market. We note no use of derivatives during the financial year.</p>
<p>4. Are you aware of any significant transaction outside the normal course of business?</p>	<p>We have created an expense code in the P&amp;L in order to record all purchase of IT Equipment, to support remote working following closure of the building for non-essential staff due to Covid 19. However, as this occurred right at the year end, this will have only had an effect in March, and on-going costs will have occurred in April therefore affecting the following year's financials.</p> <p>We have signed a contract in the financial year, for the development of our new website, however still relatively small value of £150k.</p>

## 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?	None noted – non-current assets held by ESPO are minimal and mainly consist of the building and land at Grove Park.
6. Are you aware of any guarantee contracts?	No
7. Are you aware of the existence of loss contingencies and/or un-asserted claims that may affect the financial statements?	No
8. Other than in house solicitors, can you provide details of those solicitors utilised by XX during the year. Please indicate where they are working on open litigation or contingencies from prior years?	No litigation in the year, other than health and safety claims. Greg Surtees contact details have been provided to audit team for any direct contact with our in house solicitor.
9. Have any of the XX's service providers reported any items of fraud, non-compliance with laws and regulations or uncorrected misstatements which would affect the financial statements?	None noted
10. Can you provide details of other advisors consulted during the year and the issue on which they were consulted?	None noted

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

As Management'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 Risk & Assurance 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 Management Committee oversees the above processes. We are also required to make inquiries of both management and the Management 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 ESPO's management.



## Fraud risk assessment

Question	Management response
<p>1. Have ESPO 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 ESPO's risk management processes link to financial reporting?</p>	<p>Management have assessed the risk of material misstatement due to fraud as low in the financial statements.</p> <p>We recognise the risk of management override, however due to the controls in place around journal postings, this is monitored. Also due to the lack of incentives to perpetrate fraud, we consider the risk of management override to be minimal.</p> <p>For any invoices received, these have to be authorised in our workflow system by various individuals, including the budget holder for the area the invoice is to be posted to.</p> <p>We have a strong IT control environment, also minimising the financial risk, as passwords for all programmes have to be changed regularly.</p>
<p>2. What have you determined to be the classes of accounts, transactions and disclosures most at risk to fraud?</p>	<p>As above, there is little incentive and therefore limited areas which are at risk to fraud. Inventory adjustments are historically low, segregation of duties present in recording and inputting transactions and all manual journals are reviewed.</p>
<p>3. Are you aware of any instances of actual, suspected or alleged fraud, errors or other irregularities either within ESPO as a whole or within specific departments since 1 April 2019?</p> <p>As a management team, how do you communicate risk issues (including fraud) to those charged with governance?</p>	<p>No instances of fraud noted in the financial year.</p> <p>Risk is communicated via risk register, with internal audit, the outcomes of any internal audit observations are communicated at the management and audit committee meetings.</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 ESPO where fraud is more likely to occur?</p>	<p>We have identified the consequences if risk of fraud or corruption was to occur by employees, these include; unbudgeted costs which could result in reduction of profit or a loss for ESPO, possible dismissal of staff who are responsible for fraud or who monitor/ manage the relevant system, costs of legal action, reputational damage which may occur and review of all controls to prevent future occurrence.</p> <p>We do not recognise this as a significant risk to the business due to little incentive and controls in place to monitor these risks, such as daily bank reconciliations, controls which are in place, segregation of duties and our regular internal audits.</p>
<p>5. What processes do ESPO have in place to identify and respond to risks of fraud?</p>	<p>Internal Audit, and any recommendations that are made by IA are considered and responded to in Management Committee meetings. Daily bank reconciliations. Annual external audits.</p>
<p>6. How would you assess the overall control environment for ESPO, 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>We consider there to be little incentive for employees to perpetrate fraud in ESPO – goods are not of individual significant value which are held in the warehouse, and are intended for use in schools, education, public sector.</p> <p>A lot of larger and more expensive equipment is provided to customers via direct delivery from the supplier so goods aren't physically held in our warehouse.</p> <p>Little incentive of financial manipulation as no bonus etc paid to staff based on financial results, and therefore risk of overriding controls to achieve financial targets is minimal.</p> <p>Additionally, major spending is agreed up front with members in quarterly meetings, and the budgeted surplus is shared at the start of the financial year. This also reduces any incentive to manipulate results.</p> <p>Control's are in place across the organisation at ESPO, and are reviewed regularly by internal audit. Segregation of duties is also in place, reducing fraud risk in the business.</p>

# Fraud risk assessment

Question	Management response
7. Are there any areas where there is potential for misreporting?	Rebate and Gas Revenue is recognised on a cash basis rather than accruals basis, to ensure that revenue is consistent year on year and to avoid misreporting.
8. How do XX communicate and encourage ethical behaviours and business processes of it's staff and contractors?  How do you encourage staff to report their concerns about fraud?  What concerns are staff expected to report about fraud? Have any significant issues been reported?	All new joiners are giving training, and staff also complete e learnings regularly. We have a fraud section on the intranet which is accessible to all employees, giving information and guidance and also an e-learning specific to fraud.  No issues have been reported in the year.
9. From a fraud and corruption perspective, what are considered to be high-risk posts?  How are the risks relating to these posts identified, assessed and managed?	Manual journal entries – however these are made by a small number of individuals in the strategic finance team and all journals are reviewed prior to posting into the system.
10. Are you aware of any related party relationships or transactions that could give rise to instances of fraud?  How do you mitigate the risks associated with fraud related to related party relationships and transactions?	Related party transactions are completed on an arms length basis, all member spend is tracked weekly and reported in our weekly financials which are fed to the senior leadership team.

## Fraud risk assessment

Question	Management response
<p>11. What arrangements are in place to report fraud issues and risks to the Management Committee? How does the Management 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>On the intranet there is a Whistleblowing document which outlines the steps to be taken to report fraud issues by staff. The staff should tell their manager/Head of Service/Director and then the issue is assessed as to what steps should next be taken. Additionally, Internal audit look at our processes and look at any internal control issues. Results and recommendations are shared with management.</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>None noted</p>
<p>13. Have any reports been made under the Bribery Act?</p>	<p>None noted</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 Management Committee, is responsible for ensuring that ESPO'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 Management 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.

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## 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 ESPO have in place to prevent and detect non-compliance with laws and regulations?</p> <p>Are you aware of any changes to ESPO's regulatory environment that may have a significant impact on ESPO's financial statements?</p>	<p>Procurement regulation is monitored by in house compliance team, health and safety and data protection is also looked after by in house officers however this is also overseen by LCC departments.</p> <p>No changes have been noted in the regulatory environment which would impact the 19/20 financial statements.</p>
<p>2. How is the Management Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>Appointment of appropriate individuals throughout the business, use of in-house solicitor to advise on procurement laws and regulations and any other legal disputes. Also qualified individuals appointed who are aware of laws and regulations in their area. Internal audit's completed regularly by Leicestershire County Council. Directors of area's across the business also ensures all laws and regulations are complied with, and attend quarterly management committee meetings when any issues would be discussed.</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>None noted.</p>
<p>4. Is there any actual or potential litigation or claims that would affect the financial statements?</p>	<p>No – no legal cases in the year, only health and safety related claims. These would not have any impact on the financial statements.</p>

## Impact of laws and regulations

Question	Management response
5. What arrangements does ESPO have in place to identify, evaluate and account for litigation or claims?	In house legal solicitor to look after any legal claims and litigation.
6. Have there been any report from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	None noted. HMRC visit arranged for April 2020 has been postponed to later in the year due to impact of Covid-19.

# 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 ESPO? What was the outcome of that assessment?</p>	<p>The financial statements will be prepared on a going concern basis. Assessment has been carried out based on forecasts and budgets for the financial year 20/21. Budgets are currently being revised due to Covid-19 however we do not note any change in the going concern basis of the company due to our strong cash position as well as local government support.</p>
<p>2. Are the financial assumptions in that report (e.g., future levels of income and expenditure) consistent with the financial information provided to the Management 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 ESPO, financial forecasts and report on going concern?	Yes we have considered our transition to FRS102.
4. Have there been any significant issues raised with the Management 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).	None noted.
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?	Due to the current circumstances around Covid-19, we have forecasted a decrease in cash due to a fall in revenue, and slower business performance in the next few months. We have also deferred payments of VAT and furloughed around 100 staff members in line with government guidance. Despite this, due to a strong cash balance, and still supplying necessities to the NHS and schools, we do not consider this to effect the going concern status of ESPO.

## Going concern considerations

Question	Management response
<p>6. Does ESPO have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of ESPO's objectives? If not, what action is being taken to obtain those skills?</p>	<p>Yes experienced management team, and heads of department are involved in achieving the medium and long term objectives of ESPO.</p>
<p>7. Does ESPO have procedures in place to assess their ability to continue as a going concern?</p>	<p>Yes - we assess the going concern based on our strategy, and forecasts/ budgets for following financial years.</p>
<p>8. Is management aware of the existence of events or conditions that may cast doubt on ESPO's ability to continue as a going concern?</p>	<p>No – as noted above, forecasts and budgets are being revised due to Covid-19 however we do not believe that this impacts ESPO's ability to continue as a going concern.</p>

## Going concern considerations

Question	Management response
<p>9. Are arrangements in place to report the going concern assessment to the Management Committee ?</p> <p>How has the Management Committee satisfied itself that it is appropriate to adopt the going concern basis in preparing financial statements?</p>	<p>Yes the management committee will be presented with this as well as the financial statements prepared on a going concern bases for approval.</p>

# Related Parties

## Issue

### Matters in relation to Related Parties

ESPO 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 ESPO;
- associates;
- joint ventures;
- an entity that has an interest in the authority that gives it significant influence over ESPO;
- 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 ESPO, or of any entity that is a related party of ESPO.

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 ESPO perspective but material from a related party viewpoint then ESPO 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.

## Relating Parties

Question	Management response
<p>1. What controls does ESPO have in place to identify, account for and disclose related party transactions and relationships ?</p>	<p>ESPO is required to disclose material transactions with related parties – bodies or individuals that have the potential to control or influence the organisation or to be controlled or influenced by ESPO. Disclosure of these transactions allows readers to assess the extent to which ESPO might be constrained in its ability to operate independently or might have secured the ability to limit another party's ability to bargain freely with ESPO.</p> <p>ESPO provides goods and services to all member authorities and as a consequence recognises sales revenue and has amounts owed by these member authorities:            Cambridgeshire county council, Leicestershire county council, Lincolnshire county council, Norfolk county council, Peterborough county council and Warwickshire county council.</p> <p>We note that members of the management committee who have direct control over the financial and operating policies of ESPO have not received any payment, or had any interest in work or services commissioned by ESPO.</p>

# Accounting estimates

## Issue

### Matters in relation to Related Accounting estimates

ESPO 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 Authority 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 Authority 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 Management 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)?	None noted
2. Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable?	Yes – we have not made any changes to our accounting policies for estimates in the year. We consider the arrangements in place to be reasonable.
3. How is the Management Committee provided with assurance that the arrangements for accounting estimates are adequate ?	Through discussion and challenge of ESPO management and the audit process.



## 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	Fair value for land/buildings defined as 'existing use' by ESPO.	Valuations are performed annually to ensure that the fair value of a revalued asset does not differ materially from its carrying amount. For land and buildings all material assets will be considered in 2019/20.	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 internal asset team and for the building the useful life is determined by the valuer.	Depreciation is calculated on a straight line basis as this reflects consumption of assets and is a reasonable assumption.	No

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## 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 in line with our accounting policies.	See left.	Discussion with internal asset team as appropriate.	N/A.	No.
Measurement of Financial Instruments	Financial instruments consist of loans, receivables and borrowings. Measured initially at cost and subsequently at amortised cost using the effective interest method.	See left.	None	N/A	No

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## 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 written off at the period end.	Knowledge by the Accounts Receivables team in likelihood of recoverability and the aging of the debts. The finance director will review and sign off the write off.	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	We 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 Hymans Robertson. These figures are based on making % adjustments to the closing values of assets/liabilities.	See left.	We are provided with a report from the actuary, Hymans Robertson.	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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