

Auditing Standards – Communication with the Audit & Governance  
Committee and Executive  
Redditch Borough Council

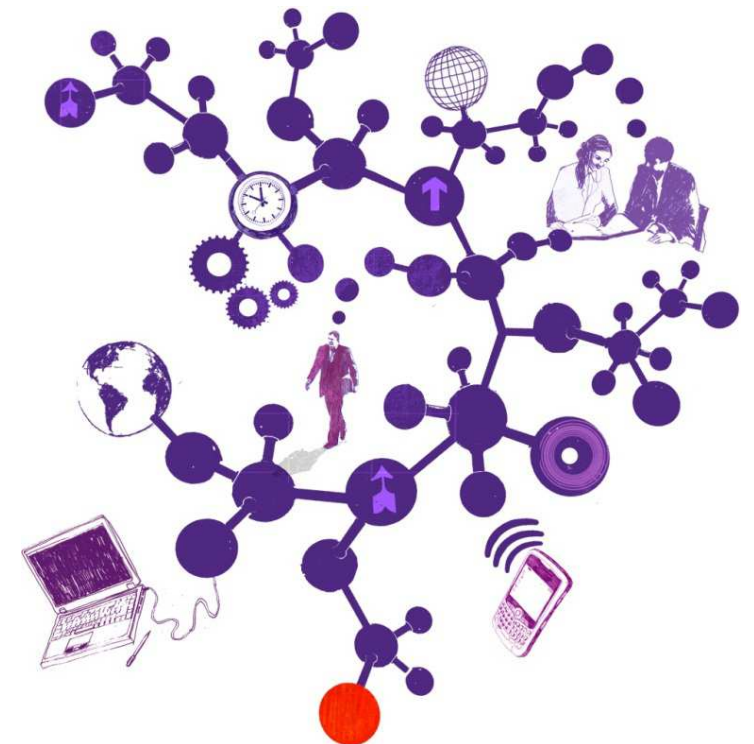
Audit year 2014/2015

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Last updated 13 April 2015

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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.

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# Introduction

The purpose of this report is to ensure there is effective two way communication between the Council's Audit, Governance and Standards Committee, who are "Those Charged with Governance" and the external auditor.

As your external auditors we have a responsibility under professional auditing standards to ensure there is effective communication with the Audit, Governance and Standards Committee. This means developing a good working relationship with members, while maintaining our independence and objectivity. If this relationship works well it helps us obtain information relevant to our audit and helps members to fulfil their financial reporting responsibilities. The overall outcome is to reduce the risk of material misstatement

In planning and performing our audit of the financial statements we need to understand how the Audit, Governance and Standards Committee, supported by the Council's management, meets its responsibilities in the following areas:

- Fraud
- Law and regulation
- Going concern
- Accounting for estimates
- Related Parties

This report summaries the respective responsibilities of Audit, Governance and Standards Committee, officers and external audit in each of these area, as set out be International Standards on Auditing (UK and Ireland) (ISAs). Our primary responsibility is to consider the risk of material misstatement.

**Each section of the report includes a series of question that management have responded to. We would like to ask the Audit, Governance and Standards Committee to consider these responses and confirm that it is satisfied with the arrangements.**

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# Fraud Risk Assessment

The ISAs define fraud as:

**"An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage."**

[ISA (UK&I) 240, paragraph 11]

The primary responsibility to prevent and detect fraud is with the Audit, Governance and Standards Committee and the Council's management. To do this:

- Officers need to ensure there is a strong emphasis on fraud prevention and deterrence, with a commitment to honest and ethical behaviour
- Audit, Governance and Standards committee oversight needs to include the potential for the override of controls and inappropriate influence over the financial reporting process

Our overall responsibility is to ensure the Council's financial statements are free from material misstatement due to either fraud or error. We are required to maintain professional scepticism through the audit, which means considering the potential for the intentional manipulation of the financial statements.

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## Fraud Risk Assessment cont..

We are also required to carry out a fraud risk assessment to inform our audit approach. This includes considering the following:

- How management assess the risk of material misstatement in the financial statements due to fraud.
- Officers' response to assessed fraud risk, including any identified specific risks.
- Investigations into data matches identified through the National Fraud Initiative and subsequent outcomes.
- How officers communicate the process for assessing and responding to fraud risk to the Audit, Governance and Standards Committee.
- How officers communicates its views on ethical behaviour to the Audit, Governance and Standards Committee.
- How the Audit, Governance and Standards Committee exercises oversight of officers' fraud risk assessment and response processes and the internal controls to mitigate these risks.
- What knowledge the Audit, Governance and Standards Committee has of actual, alleged or suspected fraud.

Table 1 sets out how Officers have responded to our financial risk assessment

# Table 1 Fraud Risk Assessment

Question	Management response
<p>1. What is officers' assessment of the risk of material misstatement in the financial statements due to fraud? Is this consistent with the feedback from your risk management processes?</p>	<p>Although there is an on-going risk of fraud being committed against the Council, arrangements are in place to both prevent and detect fraud. These include work carried out by Internal Audit on overall fraud risk areas and work on Council Tax and Housing Benefit fraud.</p> <p>There is on-going communication between external audit and responsible officers on emerging technical issues. Officers also attend technical updates. Financial monitoring reports also highlight areas of variance within the capital and revenue budgets and this assists management in identifying areas of material misstatement within the accounts.</p> <p>The Council is currently reviewing and updating its risk management processes and procedures.</p> <p>Management considers there is a low risk of material misstatement in the financial statements due to fraud.</p>

## Table 1 Fraud Risk Assessment cont.

Question	Management response
<p>2 Are you aware of any instances of fraud, either within the Council as a whole or within specific departments since 1 April 2014? If so how does the Audit, Governance and Standards Committee respond to these?</p>	<p>There are some areas that are inherently at risk from fraud such as:</p> <ul style="list-style-type: none"><li>▪ Council Tax</li><li>▪ Benefit Fraud</li><li>▪ Single person discount</li></ul> <p>However, there is a dedicated benefits investigation team which investigates any fraud and have undertaken a number of successful reviews and prosecutions during 2014/15</p> <p>The Audit, Governance and Standards Committee receives any adhoc fraud reports.</p> <p>There are no material instances of fraud that have been identified during the year.</p> <p>The Audit, Governance and Standards Committee would consider the fraud and the actions put forward by officers to ensure fraud is mitigated in the future.</p>



## Table 1 Fraud Risk Assessment cont.

Question	Management response
<p>3 Do you suspect fraud may be occurring, either within the Council or within specific departments ?</p> <ul style="list-style-type: none"> <li>▪ Have you identified any specific fraud risks?</li> <li>▪ Do you have any concerns there are areas that are at risk of fraud?</li> <li>▪ Are there particular locations within the Council where fraud is more likely to occur?</li> </ul>	<p>Evidence published by the National Fraud Authority amongst others, suggests that fraud is committed in all organisations to varying degrees, so it is likely that some fraud is occurring in the Authority.</p> <p>Locations handling income, particularly in the form of cash, are more likely to be at risk of fraud. However management does not consider these to be significant risks.</p>
<p>4 Are you satisfied that the overall control environment, including:</p> <ul style="list-style-type: none"> <li>▪ The process for reviewing the system of internal control;</li> <li>▪ Internal controls, including segregation of duties;</li> </ul> <p>exist and work effectively?</p> <p>If not where are the risk areas? 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>Yes – Internal Audit include fraud risks in their planning process and act as an effective internal control against fraud.</p> <p>Sound systems of internal control with roles and responsibilities are defined in various places such as constitution.</p> <p>The role of internal audit, provides assurance that the Council's internal controls are in place. An annual report is produced and is available prior to the annual accounts being signed and approved.</p> <p>The regular monitoring of budgets and the allocation of financial professional support to budget holders provides control and mitigation against such overrides.</p>

## Table 1 Fraud Risk Assessment cont.

Question	Management response
<p>5 How do you encourage, and communicate to, employees about your views on business practices and ethical behaviour? How do you encourage staff to report their concerns about fraud?</p> <ul style="list-style-type: none"> <li>▪ What concerns are staff expected to report about fraud?</li> </ul>	<p>There is a Fraud Strategy and Whistleblowing procedure in place which explain the procedures to follow. The Fraud Strategy will be updated during 2015/16.</p> <p>Employees are aware of the anti-fraud of the anti-fraud and corruption strategy, details are available on the website.</p> <p>There will be further updates during 2015/16 to encourage staff to report any concerns that they may have.</p>
<p>6 From a fraud and corruption perspective, what are considered to be high-risk posts:</p> <ul style="list-style-type: none"> <li>▪ How are the risks relating to these posts identified, assessed and managed?</li> </ul>	<p>There are not any significantly high-risk posts identified.</p>
<p>7 Are you aware of any related party relationships or transactions that could give rise to instances of fraud?</p> <ul style="list-style-type: none"> <li>▪ How do you mitigate the risks associated with fraud related to related party relationships and transactions?</li> </ul>	<p>2014/15 financial statements disclosure of related party transactions does not identify potential fraud risk. Members and officers are required to make full disclosure of any relationships that impact on their roles. Members are required to declare any relevant interests at Council and Committee meetings.</p>
<p>8 What arrangements are in place to report fraud issues to the Audit Governance and Standards Committee?</p> <p>How does the Audit Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control?</p>	<p>Internal Audit provide the Audit, Governance and Standards committee with updates of their work on fraud prevention and detection, including any significant identified frauds and the action taken. Any adhoc investigations are reported to the Audit, Governance and Standards committee.</p> <p>The departmental risk registers are reviewed by the Committee and the Corporate Risk Register is monitored regularly to ensure management has adequate controls in place.</p>

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## Table 1 Fraud Risk Assessment cont.

Question	Management response
9 Are you aware of any whistleblowing reports under the Bribery Act since 1 April 2014? If so, how does the Audit and Ethics Committees respond to these?	We are not aware of any whistleblowing reports. If there was such a report then members would consider the appropriate course of action.

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# Law and Regulation

Auditing standards require us to consider the impact that law, regulation and litigation may have on the Council's financial statements. The factors that may result in particular risks of material misstatement due to fraud or error are:

- The operational regulatory framework – this covers the legislation that governs the operations of the Council.
- The financial report framework – according to the requirement of International Financial Reporting Standards, the Code of Accounting for Local Authorities in England and relevant Directions.
- Taxation considerations – for example compliance with Value Added Tax and Income Tax regulations.
- Government policies that otherwise impact on the Council's business
- Other external factors; and
- Litigation and claims against the Council.

Where we become aware of information about a possible instance of noncompliance we need to gain an understanding of it to evaluate the possible effect on the financial statements.

The ISAs also require us to make enquiries of management and the Audit Governance and Standards Committee about the arrangements in place to comply with law and regulation. To help with this, management have responded to the following questions.

## Table 2 : Law and Regulation

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 the Council have in place to prevent and detect non-compliance with laws and regulations?</p>	<p>The Monitoring Officer will advise the Council's Management team and Councillors as appropriate.</p> <p>The reporting arrangements include sections for both financial and legal implications to ensure managers have considered compliance with laws and regulations. In addition staff have professional training and conduct in place to support compliance.</p>
<p>2 How is the Audit Governance and Standards Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>Assurance of complying with the Council's Constitution is provided through the Annual Governance Statement which is reported to Executive.</p>
<p>3 Have there been any instances of non-compliance with law and regulation since 1 April 2014 with any on-going impact on the 2014/15 financial statements</p>	<p>No</p>
<p>4 Is there any actual or potential litigation or claims that would affect the 2014/15 financial statements?</p>	<p>None</p>
<p>5 What arrangements does the Council have in place to identify, evaluate and account for litigation and claims?</p>	<p>The legal and finance team liaise on a regular basis to identify and evaluate any potential claims.</p>
<p>6 Have there been any reports from other regulatory bodies, such as HM Revenue and Customs which indicate non-compliance?</p>	<p>No</p>

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# Going Concern

Going concern is a fundamental principle in the preparation of the financial statements. Under the going concern assumption, a council is viewed as continuing in operation for the foreseeable future with no necessity of liquidation or ceasing trading. Accordingly, the Council's assets and liabilities are recorded on the basis that assets will be realised and liabilities discharged in the normal course of business. A key consideration of going concern is that the Council has the cash resources and reserves to meet its obligations as they fall due in the foreseeable future.

We have discussed the going concern assumption with key Council officers and reviewed the Council's financial and operating performance. Following are key questions on the going concern assumptions which we would like the Cabinet to consider.

## Table 3 : Going Concern

Question	Management response
1 Has a report been received from management forming a view on going concern?	The Director of Finance and Corporate Resources (as s151 Officer) is satisfied that the budget proposals are based on robust estimates, and that the level of reserves is adequate to support a positive going concern assessment, as is also reported in the Medium Term Financial Strategy. A separate report on Going Concern will be presented to Members as part of the final accounts approval.
2 Are the financial assumptions in that report (e.g. future levels of income and expenditure) consistent with the Council's Business Plan and the financial information provided to the Council throughout the year?	The Financial Plan is agreed by the Council as part of the Medium Term Financial Plan. The financial plan considerations in setting the medium term budget are consistent with the issues reported to Council throughout the Financial Year. Reports in year are consistent with the budget set. A Council Plan is currently being developed together with a performance framework.
3 Are the implication of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	The Financial Plan considered the government changes in terms of grants. The plan sets out the likely implications of the Governments Resources Review and other changes to local government finance such as the new Council Tax Support scheme and other council tax reforms being implemented from 1 April 2014 in addition to the Business rates retention scheme.
4 Have there been any significant issues raised with the Audit Governance and Standards 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)	Last year a report on financial resilience was presented to the Committee that had flagged up a number of concerns around the future financial capacity of the Council. This had also been considered by Executive. As a result of subsequent work done on this issue the Council now has a sustainable Medium Term Financial Plan/Strategy and has produced financially viable budgets for 2015/16 and 2016/17, 2017/18.
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

## Table 3 : Going Concern cont...

Question	Management response
<p>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</p>	<p>Yes</p>
<p>7 Does the Council have procedures in place to assess the Council's ability to continue as a going concern?</p>	<p>Yes – regular financial monitoring reports to officers and members and the successful production of a viable Medium Term Financial Plan for 2015/16, and 2016/17. 2017/18.</p>
<p>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.</p>	<p>No – the financial resilience report identified a number of financial issues that are being addressed by officers.</p>
<p>9 Are arrangements in place to report the going concern assessment to the Audit Committee?</p> <p>How has the Audit Governance and Standards Committee satisfied itself that it is appropriate to adopt the going concern basis in preparing the financial statements?</p>	<p>Regular financial monitoring is presented to the Executive and to the Council. In addition it is proposed that the savings plans are monitored on a regular basis at the Audit Governance and Standards Committee during 2015/16.</p> <p>In addition a separate report will be presented to members as part of the final accounts process.</p>



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# Accounting Estimates

Local Authorities need to apply appropriate estimates in the preparation of their financial statements. Accounting estimates are used when it is not possible to measure precisely a figure in the accounts. ISA (UK&I) 540 sets out requirements for auditing accounting estimates. The objective is to gain evidence that the accounting estimates are reasonable and the related disclosures are adequate.

Under this standard, we have to identify and assess the risks of material misstatement for accounting estimates by understanding how the Council identifies the transactions, events and conditions that may give rise to the need for an account estimate.

We need to be aware of all estimates that the Council are using as part of their accounts preparation; these are detailed in appendix 1.

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.

## Table 4: Accounting Estimates

Question	Management response
1 Are management aware of transactions, events and conditions (or changes in these) that may give rise to recognition or disclosure of significant account estimates that require significant judgement?	No, the Council utilise the services of an independent qualified valuation officer to support any judgements or valuations made.
2 Are management arrangements for the accounting estimates, as detailed in Appendix 1 reasonable?	Yes officers have reviewed the estimates and believe they are reasonable.
3 How is the Audit Committee provided with assurance that the arrangements for accounting estimates are adequate?	The professional judgement of the s151 Officer is accepted by the Committee.

# Related Parties

For local government bodies, the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) requires compliance with IAS 24: Related Party Disclosures. The Code identifies the following as related parties to local government bodies:

- entities that directly, or indirectly through one of more intermediaries, control, or are controlled by the authority (i.e. subsidiaries);
- associates
- joint ventures in which the authority is a venturer;
- an entity that has an interest in the authority that gives it significant influence over the authority
- key officers and close member of the family of key officers
- post employment benefit plan (pension fund) for the benefit of employees of the Council, or of any entity that is related party of the Council

The Code notes that, in considering materiality, regard should be had to the definition of materiality, which requires materiality to be judged from the viewpoint of both the Council and the related party.

ISA (UK&I) 550 requires us to review your procedures for identifying related party transactions and obtain an understanding of the controls that you have established to identify such transactions. We will also carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate.

## Table 5: Related Parties

Question	Management response
<p>1 Who are the Council's related parties?</p>	<p>The Council discloses its related parties under the following headings:</p> <ol style="list-style-type: none"> <li>1. Government – Central Government has control influence over the Council as the Council needs to act in accordance with its statutory responsibilities.</li> <li>2. Pension Fund – LGPS , this party is subject to common control by Central Government and is administered by Worcestershire County Council.</li> <li>3. Precepts &amp; Levies – these parties are subject to common control by Central Government and thus might be empowered to transact on non-commercial terms. The Council is bound to pay the amount demanded from these parties through precept or levy.</li> <li>4. Assisted Organisations – the provision of financial assistance by the Council to such parties or voluntary organisations may give the Council influence on how the funds are to be administered and applied.</li> <li>5. Members and Officers – certain Members and Officers may have controlling influence or related interests with other of the Council's related party organisations, such that they may be in a position to significantly influence the policies of the Council</li> </ol>

## Table 5: Related Parties cont....

Question	Management response
<p>2 What are the controls in place to identify, account for, and disclose, related party transactions and relationship?</p>	<p>A number of arrangements are in place for identifying the nature of a related party and reported value including:</p> <ul style="list-style-type: none"> <li>▪ Maintenance of a register of interests for Members a register for pecuniary interests in contracts for Officers and Senior Mangers requiring disclosure of related party transactions.</li> <li>▪ Annual return from senior managers/officers requiring confirmation that they have read and understood the declaration requirements and stating details of any known related party interests.</li> <li>▪ Review of in-year income and expenditure transactions with known identified related parties from prior year or known history.</li> <li>▪ Review of the accounts payable and receivable systems and identification of amounts paid to/from assisted or voluntary organisation.</li> <li>▪ Review of year end debtor and creditor positions in relation to the related parties identified.</li> <li>▪ Review of minutes of decision making meetings to identify any member declarations and therefore related parties.</li> </ul>

# Appendix 1 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 and equipment valuations	The Council has a contract with Worcestershire County Council property department to manage its asset base, including undertaking annual valuations. The Valuer is a RICS/CIB Member) and reviews are made inline with RICS guidance on the basis of 5 year valuations with interim reviews.	Capital Accountant notifies the valuer of the program of rolling valuations or of any conditions that warrant an interim re-valuation	Yes, the Worcestershire County Council valuer	Valuations are made in line with RICS guidance – reliance on expert.	No
Estimated remaining useful lives of PPE	The following asset categories have general asset lives: <ul style="list-style-type: none"> <li>▪Buildings 50 years</li> <li>▪Equipment/vehicles 5 years</li> <li>▪Plant 12 years</li> <li>▪Infrastructure 40 years</li> </ul>	Consistent asset lives applied to each asset category.	Yes, the Worcestershire County Council valuer	The method makes some generalisations. For example, buildings tend to have a useful life of 50 years. Although in specific examples based upon a valuation review, a new building can have a life as short as 25 years or as long as 70 years depending on the construction material used. This life would be recorded in accordance with the local qualified RICS or CIB Member.	

# Appendix 1 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?
Depreciation & Amortisation	Depreciation is provided for on all fixed assets with a finite useful life on a straight-line basis.	Consistent application of depreciation method across all assets	No	<p>The length of the life is determined at the point of acquisition or revaluation according to:</p> <ul style="list-style-type: none"> <li>▪ Assets acquired in the first half of a financial year and depreciated on the basis of a full year's charge; assets acquired in the second half are not depreciated until the following financial year.</li> <li>▪ Assets that are not fully constructed are not depreciated until they are brought into use.</li> </ul>	No
Impairments	Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired. Where indications exist and any possible differences are estimated to be material, the recoverable	Assets are assessed at each year end as to whether there is any indication that an asset may be impaired	Worcester-shire County Council Valuer	Valuations are made in line with RICS guidance – reliance on expert	No

# Appendix 1 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?
Impairments cont..	amount of the asset is estimated and, where this is less than the carrying amount of the asset, an impairment loss is recognised for the shortfall.			is made ), the provision is reversed and credited back to the relevant service. Where some or all of the payment required to settle a provision is expected to be recovered from another party (e.g. from an insurance claim), this is only recognised as income.	
Non adjusting events – events after the BS date.	S151 Officer makes the assessment. If the event is indicative of conditions that arose after the balance sheet date then this is an unadjusting event. For these events only a note to the accounts is included, identifying the nature of the event and where possible estimates of the financial effect.	Heads of Services notify the s151 Officer	This would be considered on individual circumstances	This would be considered on individual circumstances	N/A



# Appendix 1 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?
Overhead allocation	The Cost Centre Management Team apportion central support costs to services based on fixed bases as detailed in the 'Allocation Summary' spread sheet.	All support service cost centres are allocated according to the agreed 'Allocation Summary' spread sheet	No	Apportionment bases are reviewed each year to ensure equitable	No
Measurement of Financial Instruments	Council values financial instruments at fair value based on the advice of their internal treasury consultants and other finance professions.	Take advice from finance professionals	Yes	Take advice from finance professionals	No
Bad Debt Provision	A provision is estimated using a proportion basis of an aged debt listing.	An aged debt listing is provided routinely and finance calculate the provision	No	Consistent proportion used across aged debt as per SORP	No

# Appendix 1 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?
Provisions for liabilities	Provisions are made where an event has taken place that gives the Council a legal or constructive obligation that probably requires settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation. Provisions are charged as an expense to the appropriate service line in the CIES in the year that the Council becomes aware of the obligation, and are measured at the best estimate at the balance sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties.	Charged in the year that the Council becomes aware of the obligation	No	Estimated settlements are reviewed at the end of each financial year – where it becomes less than probable that a transfer of economic benefits will now be required (or a lower settlement than anticipated is made), the provision is reversed and credited back to the relevant service. Where some or all of the payment required to settle a provision is expected to be recovered from another party (e.g. from an insurance claim), this is only recognised as income for the relevant service if it is virtually certain that reimbursement will be received by the Council.	No

# Appendix 1 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?
Accruals	CCMT collate accruals of Expenditure and Income. Activity is accounted for in the financial year it takes place, not when money is paid or received.	Activity is accounted for in the financial year that it takes place, not when money is paid or received.	No	Accruals for income and expenditure have been principally based on known values. Where accruals have had to be estimated the latest available information has been used.	No