

## **Audit Committee**

**30 June 2021**

### **Compliance with International Auditing Standards – Durham County Council including Pension Fund**



## **Report of Councillor Alex Watson, Chair of the Audit Committee**

### **Purpose of the Report**

- 1 This report presents the proposed responses to the questions put to the Committee in a letter dated 27 April 2021, as detailed in Appendix 2. The questions posed by the External Auditor seek to evidence how management and those charged with governance are discharging their responsibilities.

### **Executive summary**

- 2 A letter received from the External Auditor dated 27 April 2021 set out a series of questions to evidence how management and those charged with governance are discharging their responsibilities. The letter is attached at Appendix 2.
- 3 The proposed response on behalf of the committee is detailed at Appendix 3. There are no significant issues or concerns to bring to the Committee's attention.

### **Recommendation(s)**

- 4 Members are asked to:
  - (a) Agree the response to the External Auditor, as set out at Appendix 3.

## **Background**

- 5 The External Auditor requested in a letter to Members of the Audit Committee dated 27 April 2021 that the Committee consider and provide a response to a range of questions in order to obtain evidence of how management and those charged with governance are discharging their responsibilities in order for the External Auditor to discharge their duties under International Standards for Auditing (ISA).

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**Contact:** Stephen Carter

Tel: 03000 269665

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## **Appendix 1: Implications**

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### **Legal Implications**

Compliance with International Standards for Auditing

### **Finance**

The response to the questions posed will serve as information used by the External Auditor for their work on the Council's Statement of Accounts for 2020/21.

### **Consultation**

The Chair and Vice Chair of the Audit Committee have been consulted in drafting this response.

### **Equality and Diversity / Public Sector Equality Duty**

There are no equality and diversity / public sector equality duty implications as a result of this report.

### **Climate Change**

There are no climate change implications as result of this report.

### **Human Rights**

There are no human rights implications as a result of this report.

### **Crime and Disorder**

There are no crime and disorder implications as a result of this report.

### **Staffing**

There are no staffing implications as a result of this report.

### **Accommodation**

There are no accommodation implications as a result of this report.

### **Risk**

There are no direct risk implications as a result of this report.

### **Procurement**

There are no direct procurement implications as a result of this report.

## Appendix 2: External Auditors Letter containing Questions for the Committee



The Corner  
Bank Chambers  
26 Mosley Street  
Newcastle upon Tyne  
NE1 1DF

Tel: +44 (0)191 383 6300  
www.mazars.co.uk

Audit Committee  
Durham County Council  
County Hall  
DH1 5UQ

Direct +44 (0)191 383 6331  
Dial  
Email james.collins@mazars.co.uk

27 April 2021

Dear Audit Committee Members

**Durham County Council (including Pension Fund) – 2020/21: Audit Committee briefing note - ISA240 (Fraud), ISA250 (laws and regulations), ISA501 (litigation and claims) & ISA570 (going concern)**

### Introduction

This letter aims to summarise for the Audit Committee the requirements under International Auditing Standards, in respect of preventing fraud in the annual accounts, compliance with laws and regulations, litigation and claims, and going concern. This letter requests an update from the Audit Committee in order to inform our continuous audit planning prior to the start of the final stage of our audit of Durham County Council's (the Council) 2020/21 accounts.

### **International Standard for Auditing 240 - The auditor's responsibility to consider fraud in an audit of financial statements**

#### Background

Under the ISA, the primary responsibility for preventing and detecting fraud rests with both management and 'those charged with governance', which for the Council is the Audit Committee.

The ISA requires us, as external auditors, to obtain an understanding of how the Committee exercises oversight of management's processes for identifying and responding to the risks of fraud and the internal controls established to mitigate them.

#### What is 'fraud' in the context of the ISA?

The ISA views fraud as either:

- the intentional misappropriation of the Council's assets (cash, property, etc); or
- the intentional manipulation or misstatement of the financial statements.

#### What are auditors required to do?

We have to obtain evidence of how management and those charged with governance are discharging their responsibilities, if we are to properly discharge our responsibilities under ISA240. We are

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therefore making requests from the Audit Committee and management on the following, or similar, issues:

1) How does the Audit Committee oversee management's processes to identify and respond to the risk of fraud and possible breaches of internal control? In particular how the Committee oversees managements:

- Assessment of the risk that the financial statements may be materially misstated due to fraud or error;
- Processes for identifying and responding to risks of fraud in the organisation. This includes any specific risks of fraud which management have identified or that have been brought to its attention, or classes of transactions, account balances, or disclosure for which a risk of fraud is likely to exist;
- Processes for communicating to employees the views on business practice and ethical behaviour. For example updating, communicating and monitoring against the Council's code of conduct; and
- Processes for communicating to those charged with governance the arrangements for identifying and responding to fraud or error

2) Has the Audit Committee knowledge of any actual, suspected or alleged fraud during the period 1 April 2020– 31 March 2021?

3) Has the Audit Committee identified any specific fraud risks within the organisation? For example does it have any concerns that specific areas within the organisation are at greater risk of fraud?

4) Is the Audit Committee aware of any significant breaches of internal control during 2020/21?

5) Is the Audit Committee satisfied that internal controls, including segregation of duties, exist and work effectively? If 'yes', please provide details of these controls. If not:

- Where are the risk areas?
- What other controls are in place to prevent, deter or detect fraud?

6) Is the Audit Committee aware of any related party relationships or transactions that could give rise to instances of fraud?

7) How does the Audit Committee mitigate the fraud risks associated with related party relationships and transactions?

8) Is the Audit Committee aware of any entries made in the accounting records of the organisation that it believes or suspects are false or intentionally misleading? In particular:

- Are there particular balances where fraud is more likely to occur?
- Is the Audit Committee aware of any assets, liabilities or transactions that it believes were improperly included or omitted from the accounts of the organisation?
- Are there any external fraud risk factors which create a high risk of fraud?

9) Is the Audit Committee aware of any organisational, or management pressure to meet financial or operating targets?

10) Is the Audit Committee aware of any inappropriate organisational or management pressure being applied, or incentives offered, to employees to meet financial or operating targets?

## **International Standard for Auditing 250 – Consideration of laws and regulations in an audit of financial statements**

### Background

Under the ISA, in the UK and Ireland, the primary responsibility for ensuring that the entity's operations are conducted in accordance with laws and regulations and the responsibility for the prevention and detection of non compliance rests with management and 'those charged with governance', which for the Council is the Audit Committee. The ISA requires us, as external auditors, to obtain an



understanding of how the Committee gains assurance that all relevant laws and regulations have been complied with.

#### What are auditors required to do?

We have to obtain evidence of how management and those charged with governance are discharging their responsibilities, if we are to properly discharge our responsibilities under ISA250. We are therefore making requests from the Audit Committee, and will be making similar enquiries of management:

11) How does the Audit Committee gain assurance that all relevant laws and regulations have been complied with. In particular:

- Is the Committee aware of the process management has in place for identifying and responding to changes in laws and regulations? Please provide details.
- What arrangements are in place for the Committee to oversee this process?
- Is the Committee aware of the arrangements management have in place, for communicating with employees, Members and stakeholders regarding the relevant laws and regulations that need to be followed?

12) Does the Committee have knowledge of actual or suspected instances where appropriate laws and regulations have not been complied with? If it is, what actions are management taking to address non-compliance?

### **International Standard for Auditing 501 – Specific consideration of the potential for, and actual, litigation and claims affecting the financial statements**

#### Background

This ISA deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence, in this instance with respect to the completeness of litigation and claims involving the entity. The ISA requires us, as external auditors, to design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement.

#### What are auditors required to do?

We have to obtain evidence of how management and those charged with governance are discharging their responsibilities, if we are to properly discharge our responsibilities under ISA501. We are therefore making requests from the Audit Committee, and will be making similar enquiries of management:

13) Is the Audit Committee aware of any actual or potential litigation and claims involving the Council that would impact on the financial statements?

### **International Standard for Auditing 570 – Consideration of the going concern assumption in an audit of financial statements**

#### Background

Financial statements are generally prepared on the basis of the going concern assumption. Under the going concern assumption, an audited body is ordinarily viewed as continuing in operation for the foreseeable future. Accordingly, assets and liabilities are recorded in financial statements on the basis that the audited body will be able to realise its assets and discharge its liabilities in the normal course of its operations.

#### What are auditors required to do?

If used, we are required to consider the appropriateness of management's use of the going concern assumption in the preparation of the financial statements if we are to properly discharge our



responsibilities under ISA570. We are therefore making the following request from the Audit Committee:

14) How has the Audit Committee assessed and satisfied itself that it is appropriate to adopt the going concern basis in preparing the financial statements?

15) Has the Audit Committee identified any events or conditions since the assessment was undertaken which may cast significant doubt on the organisation's ability to continue as a going concern?

### **Consideration of related parties**

The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions or balances in accordance with the requirements of the framework.

Therefore we are making the following request from the Audit Committee:

16) What controls are in place to: identify, authorise, approve, account for and disclose related party transactions and relationships?

17) Confirmation that the Audit Committee have:

- disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which they are aware; and
- appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework.

### **The way forward**

The information you provide will help inform our understanding of the Council and its business processes, prior to the start of the final stage of the audit of the 2020/21 financial statements.

I would be grateful for your responses, which should be formally considered and communicated to us on the Committee's behalf to cover the period to 31 March 2021, by September 2021. In the meantime, if you have any queries, please do not hesitate to contact me.

Yours sincerely

**James Collins**  
Senior Audit Manager

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## Appendix 3: Response to External Auditors Questions

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### The auditor's responsibility to consider fraud in an audit of financial statements

- 1) *How does the Audit Committee oversee management's processes to identify and respond to the risk of fraud and possible breaches of internal control? In particular how the Committee oversees managements:*
- *Assessment of the risk that the financial statements may be materially misstated due to fraud or error;*
  - *Processes for identifying and responding to risks of fraud in the organisation. This includes any specific risks of fraud which management have identified or that have been brought to its attention, or classes of transactions, account balances, or disclosure for which a risk of fraud is likely to exist;*
  - *Processes for communicating to employees the views on business practice and ethical behaviour. For example updating, communicating and monitoring against the Council's code of conduct; and*
  - *Processes for communicating to those charged with governance the arrangements for identifying and responding to fraud or error.*

The Audit Committee maintains an oversight of management processes in place for assessing the risk that the financial statements may be materially misstated by considering all the sources of assurance that it has available to it on the effectiveness of the internal control environment. This is demonstrated through quarterly internal audit progress reports and the Annual Audit Opinion and Internal Audit Report that is presented to the Committee by the Chief Internal Auditor and Corporate Fraud Manager.

The Audit Committee also receives quarterly risk reports from the Risk and Governance Manager where key strategic risks are brought to the attention of the Committee.

The Audit Committee is responsible for considering proposed changes to the Council's Counter Fraud and Corruption Strategy and the Confidential Reporting Code (Whistleblowing). The Audit Committee have also considered changes to the Council's Fraud Response Plan that supports the Counter Fraud and Corruption Strategy and to the Council's Money Laundering Policy.

Members of the Committee are aware of how to report any suspected fraud and are satisfied that employees are encouraged to report their concerns about fraud and both are supported by the Confidential Reporting Code (Whistleblowing) which is formally reviewed by the Committee.

The Committee is responsible for considering any proposed amendments to the Council's Code of Local Governance prior to approval by Full Council, and maintains an understanding of key corporate policies and procedures that are an integral part of the Council's Internal Control Framework to help mitigate the risk of fraud e.g. officers and members code of conduct, financial procedure rules, contract procedure rules, officer scheme of delegations, complaints procedures and performance management arrangements.

**2) *Has the Audit Committee knowledge of any actual, suspected or alleged fraud during the period 1 April 2020 – 31 March 2021?***

The Audit Committee is aware that all suspected cases of corporate fraud must be reported to the Chief Internal Auditor and Corporate Fraud Manager and are advised of all potential and proven cases reported.

Details of all actual, suspected or alleged fraud and action taken in response are as reported by the Chief Internal Auditor and Corporate Fraud Manager in their bi-annual 'Protecting the Public Purse' reports.

**3) *Has the Audit Committee identified any specific fraud risks within the organisation? For example does it have any concerns that specific areas within the organisation are at greater risk of fraud?***

The Committee is aware that certain posts, such as those involved with treasury management activities and those with access to the Council's bank accounts and cash carry a higher risk and consequently covered by fidelity guarantee insurance.

The Committee also receives assurance from Internal Audit from planned work around key financial systems and the counter fraud plan that is reported through the bi-annual 'Protecting the Public Purse' reports.

The Committee therefore has no specific concerns that would impact on the Statement of Accounts as it gains the assurance required as described.

**4) *Is the Audit Committee aware of any significant breaches of internal control during 2020/21?***

The Audit Committee receives quarterly Internal Audit progress reports. These progress reports highlight any assurance audit that has been given a 'Limited' assurance audit opinion. The Chief Internal Auditor and Corporate Fraud Manager has established 'follow up' arrangements in place to give the Audit Committee assurance that recommendations to improve the Internal Control environment are being made. In addition the Committee regularly calls officers to attend its meetings in order to ascertain their intentions for control improvements. Therefore, the Audit Committee can confirm that they are unaware of any significant breaches of Internal Control during 2020/21 that impact negatively on the Statement of Accounts.

**5) *Is the Audit Committee satisfied that internal controls, including segregation of duties, exist and work effectively?***

The Audit Committee receives the Annual Internal Audit Opinion and Internal Audit Report from the Chief Internal Auditor and Corporate Fraud Manager that gives assurance that the Internal Controls are working effectively and also receive regular quarterly reports on Internal Audit progress. As such the Audit Committee is satisfied that internal controls both exist and work effectively.

In addition, the Audit Committee also reviews the draft Annual Governance Statement where in addition to the assurance from the Chief Internal Auditor and Corporate Fraud Manager the Committee also receive statements from Corporate Directors that confirm from their perspective that controls are working effectively.

Any areas of weakness are brought to the attention of the Committee through the quarterly reports and Senior Managers attend the Committee to explain the improvements that will be made.

**6) *Is the Audit Committee aware of any related party relationships or transactions that could give rise to instances of fraud?***

The Audit Committee is not aware of any related party relationships or transactions that could give rise to instances of fraud.

**7) *How does the Audit Committee mitigate the fraud risks associated with related party relationships and transactions?***

The Audit Committee is aware that all Members and Corporate Management Team are required to complete an annual return of related party relationships and transactions and guidance notes have been issued to support their completion. Where any related transactions are declared extracts are obtained from Accounts Payable (Creditors) to identify actual payments made and received.

In addition, Internal Audit carries out periodic reviews of all employees and members' declarations to help identify any potential undeclared relationships and / or fraudulent transactions using outputs from data matching exercises. The last review was completed as part of the National Fraud Initiative 2020/21.

The Committee is also aware that Corporate Finance have prepared a list of all related party transactions, with an explanation of the nature of these and whether any transactions have been entered into with these related parties during 2020/21. These are included in the 2020/21 statement of accounts for the Audit Committee's approval in June 2021.

**8) *Is the Audit Committee aware of any entries made in the accounting records of the organisation that it believes or suspects are false or intentionally misleading? In particular:***

- ***Are there particular balances where fraud is more likely to occur?***
- ***Is the Audit Committee aware of any assets, liabilities or transactions that it believes were improperly included or omitted from the accounts of the organisation?***
- ***Are there any external fraud factors which create a high risk of fraud?***

The Audit Committee is not aware of any specific entries made in the accounting records of the Council that it believes or suspects are false or intentionally misleading.

**9) *Is the Audit Committee aware of any organisational, or management pressure to meet financial or operating targets?***

The Audit Committee is not aware of any organisational or management pressure to meet financial or operating targets.

**10) *Is the Audit Committee aware of any inappropriate organisational or management pressure being applied, or incentives offered to employees to meet financial or operating targets?***

The Audit Committee is not aware of any inappropriate organisational or management pressure being applied or incentives offered, to employees to meet financial or operating targets.

**Consideration of laws and regulations in an audit of financial statements**

**11) *How does the Audit Committee gain assurance that all relevant laws and regulations have been complied with?***

The Audit Committee is responsible for the review of the Council's Local Code of Corporate Governance and approving the Annual Governance Statement and is therefore aware of management arrangements in place for identifying and responding to changes in laws and regulations and any significant governance issues arising as a result.

The Audit Committee gains independent assurance over the effectiveness of the arrangements in place through the work of Internal and External Audit and other external review bodies.

The Audit Committee receives regular updates on the management of strategic risks that include risks relating to non-compliance with laws and regulations.

**12) *Does the Committee have knowledge of actual or suspected instances where appropriate laws and regulations have not been complied with? If it is, what actions are management taking to address non-compliance?***

The Audit Committee does not have any knowledge of any actual or suspected instances where appropriate laws and regulations have not been complied with.

### **Specific consideration of the potential for, and actual, litigation and claims affecting the financial statements**

**13) *Is the Audit Committee aware of any actual or potential litigation and claims involving the Council that would impact on the financial statements?***

The Audit Committee is aware of the monitoring and reporting arrangements in place of financial risks associated with potential litigation claims and seeks to gain assurance that processes are effective and that any material amounts, significant risks or control implications are brought to its attention.

### **Consideration of the going concern assumption in an audit of financial statements**

**14) *How has the Audit Committee assessed and satisfied itself that it is appropriate to adopt the going concern basis in preparing the financial statements?***

The Audit Committee considered a report of the Corporate Director of Resources at its meeting on 30 June 2021 relating to an assessment of the going concern assumption. The Committee is satisfied that it is appropriate to adopt the going concern basis in preparing the 2020/21 financial statements.

**15) *Has the Audit Committee identified any events or conditions since the assessment was undertaken which may cast significant doubt on the organisation's ability to continue as a going concern?***

The Audit Committee has not identified any events or conditions since this assessment was considered which casts any doubt on the Council's ability to continue as a going concern.

### **Consideration of related parties**

**16) *What controls are in place to: identify, authorise, approve, account for and disclose related party transactions and relationships?***

The Audit Committee is aware that all Members and Corporate Management Team are required to complete an annual return of related party relationships and transactions and guidance notes have been issued to support their completion. Where any related transactions are declared extracts are obtained from Accounts Payable (Creditors) to identify actual payments made and received.

In addition, Internal Audit carries out periodic reviews of all employees and members' declarations to help identify any potential undeclared relationships

and / or fraudulent transactions using outputs from data matching exercises. The last review was completed as part of the National Fraud Initiative 2020/21.

The Committee is also aware that Corporate Finance has prepared a list of all related party transactions, with an explanation of the nature of these and whether any transactions have been entered into with these related parties during 2020/21. These will be included in the 2020/21 statement of accounts for the Audit Committee's approval in June 2021.

**17) Confirmation that the Audit Committee have:**

- ***Disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which they are aware; and***
- ***Appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework.***

The Audit Committee confirms that the identity of all the authority's related parties have been appropriately disclosed in accordance with the requirements of the framework.