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## **Durham County Council (including the Pension Fund) 2012/13**

### **Audit Committee letter: ISA+240 (Fraud), ISA+250 (laws and regulations), ISA+501 (litigation and claims) & ISA+570 (going concern)**

#### **Introduction**

This letter aims to summarise for the Audit Committee the requirements under International Auditing Standards (UK and Ireland), also referred to as ISA+, in respect of preventing fraud in the annual accounts, and compliance with laws and regulations, litigation and claims and going concern. It sets out the information we will require from the Audit Committee before we give our opinion on the Durham County Council's 2012/13 accounts including the Pension Fund accounts.

#### **International Standard for Auditing (UK and Ireland) 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. This includes fraud that could impact on the accuracy of the annual accounts. 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.

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### What are we 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 ISA+240. We are therefore making requests from the Audit Committee and management on the following, or similar, issues:

- 1) How does the Audit Committee, in its role as those charged with governance, exercise oversight of management's processes in relation to:
  - undertaking an assessment of the risk that the financial statements may be materially misstated due to fraud or error (including the nature, extent and frequency of these assessments);
  - identifying and responding to risks of fraud in the organisation, including 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;
  - communicating to employees of views on business practice and ethical behaviour (for example by updating, communicating and monitoring against the organisation's code of conduct); and
  - communicating to those charged with governance the processes for identifying and responding to fraud or error
- 2) How does the Audit Committee oversee management processes to identify and respond to the risk of fraud and possible breaches of internal control? Is the Audit Committee aware of any breaches of internal control during 2012/13?
- 3) Has the Audit Committee knowledge of any actual, suspected or alleged fraud during the period 1 April 2012 – 31 March 2013?
- 4) Has the Audit Committee any suspicion that fraud may be occurring within the organisation?
  - Has the Audit Committee identified any specific fraud risks within the organisation?
  - Does the Audit Committee have any concerns that there are areas within the organisation that are at risk of fraud?
  - Are there particular locations within the organisation where fraud is more likely to occur?
- 5) Is the Audit Committee satisfied that internal controls, including segregation of duties, exist and work effectively?
  - If not, where are the risk areas?
  - What other controls are in place to help prevent, deter or detect fraud?
- 6) Is the Audit Committee satisfied that staff are encouraged to report their concerns about fraud, and the types of concerns they are expected to report?
- 7) From a fraud and corruption perspective, what are considered by the Audit Committee to be high risk posts within the organisation?
  - How are the risks relating to these posts identified, assessed and managed?

- 8) Is the Audit Committee aware of any related party relationships or transactions that could give rise to instances of fraud?
- How are the risks associated with fraud related to such relationships and transactions mitigated?
- 9) 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?
- 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?
  - Could a false accounting entry escape detection? If so, how?
  - Are there any external fraud risk factors which are high risk of fraud?
- 10) Is the Audit Committee aware of any organisational, or management pressure to meet financial or operating targets?
- Is the Audit Committee aware of any inappropriate organisational or management pressure being applied, or incentives offered, to you or colleagues to meet financial or operating targets?

## **International Standard for Auditing (UK and Ireland) 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 we 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 ISA+250. 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. For example:
- Is the Committee aware of the process management has in place for identifying and responding to changes in laws and regulations?
  - 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, non-executive directors, partners and stakeholders regarding the relevant laws and regulations that need to be followed?
  - Does the Committee have knowledge of actual or suspected instances where appropriate laws and regulations have not been complied with, and if so is it aware of what actions management is taking to address it?

## **International Standard for Auditing (UK and Ireland) 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 we 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 ISA+501. We are therefore making requests from the Audit Committee, and will be making similar enquiries of management:

- 12) Is the Audit Committee aware of any actual or potential litigation or claims that would affect the financial statements?

## **International Standard for Auditing (UK and Ireland) 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 we 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 ISA+570. We are therefore making the following request from the Audit Committee:

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

The information you provide will inform our understanding of the Council and its business processes, and to enable an opinion to be given on your 2012/13 financial statements.

I would be grateful for your responses, which should be formally considered and communicated to us on the Committee's behalf, by 30 April 2013. In the meantime, if you have any queries, please do not hesitate to contact me.

Catherine Banks  
Senior Manager  
11 March 2013