

AUDIT COMMITTEE

26TH MAY 2011



ISA620 Letter to 'Those Charged with Governance

Report of the Manager of Internal Audit & Risk

Corporate Director Resources, Don McLure

Purpose of the Report

1. To inform Members of a request made by the Audit Commission, as part of the 2010/11 final accounts audit process, relating to the requirements under International Auditing Standards (UK and Ireland) in respect of preventing fraud and compliance with laws and regulations.
2. A copy of the response from the Chair and a copy of the response provided by the Corporate Director of Resources, in response to a similar request, are attached for information as Appendix 2.

Recommendation

3. Members are requested to note the response provided to the Audit Commission on behalf of the Audit Committee.

Contact: Avril Wallage, Manager of Internal Audit & Risk, Tel 0191 383 3537

Appendix 1: Implications

Finance

No direct financial implications

Staffing

None

Equality and Diversity

None

Accommodation

None

Crime and disorder

None

Human Rights

None

Consultation

None

Procurement

None

Disability Discrimination

None

Legal Implications

None

Catherine Banks
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4th May 2011

Dear Catherine,

**Audit of Durham County Council's Financial Statements
(including Pension Fund Accounts) - Compliance with
International Auditing Standards**

I refer to your email dated 14th February 2011 regarding the above.

I am aware of the response that has already been provided by Don McLure as the Section 151 Officer but would add the following comments from the Audit Committee's perspective.

ISA + 240 - Management processes in place in relation to fraud

How does the Audit Committee exercise oversight of the management processes in relation to fraud?

The Audit Committee is responsible for considering proposed changes to the Council's Counter Fraud and Corruption Strategy and supporting Fraud Response Plan, prior to approval by Cabinet, and is therefore well aware of the management processes in place for identifying and responding to the risk of fraud.

In addition, the Audit Committee receives updates, twice a year, of Counter Fraud Activity and is aware of a number of actions being undertaken or planned to help embed a strong counter fraud culture.

The Audit Committee is advised of any fraud investigations carried out through Internal Audit Quarterly Progress.

The risk of fraud and corruption has also been recognised as a Corporate Strategic Risk and the Audit Committee is kept informed of how this risk is being managed as part of quarterly risk management update reports.

The Audit Committee undertakes an assessment of the risk that the financial statements may be materially misstated due to fraud by considering all the sources of assurances it has available to it on the effectiveness of the control environment. These sources include Internal

Audit, External Audit, management (throughout the Council), risk management, section 151 and monitoring officer and other external review bodies.

ISA+250 - Management processes in place in relation to compliance with relevant laws and regulations

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

The Audit Committee is responsible for the annual 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 is not aware of any instances where the Council has not complied with any laws or regulations.

A copy of this response and that provided by the Corporate Director Resources will be presented at the next meeting of the Audit Committee on the 26th May for information.

Yours sincerely

Edward Bell
Chair of Durham County Council Audit Committee

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4th May 2011

Dear Catherine,

Audit of Durham County Council's Financial Statements (including Pension Fund Accounts) - Compliance with International Auditing Standards

With reference to your letter dated 14th February 2011 I would like to make the following comments:

ISA + 240 - Management processes in place in relation to fraud

- 1. We seek an understanding of management's assessment of the risk that the financial statements may be misstated due to fraud.***

It is considered that this issue has been addressed through the following responses, and it is considered that adequate processes are in place to prevent a material misstatement in the accounts due to fraud.

- 2. Does management have knowledge of any actual or suspected fraud, and if so what action is management taking to address it?***

Management is aware of a number of proven and potential frauds. The majority of cases relate to housing benefit that have either been disclosed through data matching exercises (Audit Commission and the Housing Benefit Service) or through its own fraud and error investigative procedures. Action taken in response to proven housing benefit fraud is in accordance with the Council's Housing Benefit Sanction Policy. This involves recovery action through court prosecution, or the imposing of administrative penalties or cautions, as considered most appropriate in accordance with the sanction policy.

All other types of potential fraud must be reported to the Head of Internal Audit, in accordance with the Council's Counter Fraud and Corruption

Strategy and supporting Fraud Response Plan, who will then agree, with the appropriate officers, how the matter will be investigated.

The Council has a zero tolerance approach to fraud and proven cases will be dealt with under the appropriate disciplinary procedures and, if considered appropriate, a referral to the Police will be made. Wherever possible sums lost will be recovered through whatever means are available to the Council.

In accordance with the Council's Counter Fraud and Corruption Strategy, proven cases will be publicised to act as a deterrent.

The Head of Internal Audit is responsible for the development and effective implementation of the Council's Counter Fraud and Corruption Strategy and leads on a number of initiatives to help combat fraud through raising awareness of the risks, supported through a dedicated Counter Fraud Officer. Specific communications to staff are through newsletters, staff magazine and a dedicated counter fraud section of the intranet. External communications are through fraud leaflets in customer access points, the Durham County News and a dedicated fraud section on the internet. More work is planned in this area to help embed a strong counter fraud culture across the whole Council, including the development of online fraud awareness training and support for Schools and Governors in raising fraud awareness; and to improve the reporting to senior management. A number of actions identified yet to be implemented are included in various service improvements plans which are monitored on a regular basis.

The risk of fraud and corruption is recognised as a corporate strategic risk and is monitored through the Council's Risk Management processes.

Bi-annual reports are made to the Audit Committee on counter fraud activity and investigations carried out in relation to fraud by Service staff or by internal audit are reported through quarterly progress reports.

3. Does management have any suspicion that fraud may be occurring within the organisation?

Within any organisation of the size of Durham County Council there is the potential for fraud to be occurring. However, the policies, procedures and processes outlined above and the continual further development of raising fraud awareness seek to further embed a strong counter fraud culture.

4. Is management satisfied that internal controls, including segregation of duties, exist and work effectively?

Independent assurance on the effectiveness of the control environment is provided through the Head of Internal Audit's Annual Audit Opinion. This is yet to be finalised for 2010/1 but will be considered by CMT and the Audit Committee shortly.

Corporate Directors also consider other assurance sources and the effectiveness of internal controls operating within their service groupings when providing assurance statements in support of the Council's Annual

Governance Statement (AGS). This is the currently being prepared and will be reported in CMT and Audit Committee in June.

5. *Is management satisfied that staff are encouraged to report their concerns about fraud, and the types of concerns they are expected to report?*

The Council has a Confidential Reporting Code (Whistle Blowing Policy) that is effectively communicated through staff induction and is easily accessible. Work continues to be undertaken as part of the “Combating fraud through awareness”, campaign, reminding staff of their responsibilities to report any concerns, the types of concern they should report and how to do this. Information is available, internally through the intranet and also externally, for members of the public, through the internet, and details several methods of reporting suspected breaches, both to Durham County Council and external fraud agencies/hotlines.

6. *Is management aware of the posts which are considered to be high risk from a fraud and corruption perspective and what action has been taken to manage this risk?*

This is considered as part of the internal audit risk management processes and the overall corporate management practices, policies and procedures in place. The fidelity guarantee insurance provision provides additional redress for any financial loss or exposure. Training continues to be developed that will be rolled out to all employees and further training will be targeted to those staff working in higher risk areas. Internal Audit has also devised an annual counter fraud programme of work, agreed by Corporate Management Team and the Audit Committee as part of their annual audit plan, to provide independent assurance that internal controls are operating effectively in high risk areas.

The Council has an employee Code of Conduct in place that is effectively communicated to all employees through induction and is easily accessible. This outlines the ethical behaviour that is expected of all staff and the processes in place should any member of staff be suspected of breaching this code. Again, work undertaken, and in progress, to raise awareness of the Council’s Counter Fraud and Corruption Strategy will remind staff of their individual responsibility and relevant policies and procedure.

7. *Is management aware of any related party relationships or transactions that could give rise to instances of fraud?*

The Council has an employee Code of Conduct in place which clearly communicates the responsibilities of staff and requires officers to complete declarations of interest where appropriate. It is management’s responsibility to ensure compliance with this Code and to monitor the nature of any interests declared.

The Council has a member’s Code of Conduct in place which clearly communicates the responsibilities of members, during meetings, with regard to declarations of interests. Procedures are in place for the recording, maintaining and monitoring of such declarations.

A register of interests of members and co-opted members of the council, as required under section 81(1) of the Local Government Act 2000, is maintained which details the declaration of financial and other interests.

ISA+250 - Management processes in place in relation to compliance with relevant laws and regulations

8. What arrangements are in place to ensure the Council complies with all relevant laws and regulations?

The arrangements in place to ensure the Council complies with all relevant laws and regulations are outlined below.

The Council has a local Code of Corporate Governance developed in accordance with CIPFA/SOLACE guidance. This Code is part of the Council's Constitution and is communicated internally and externally. This is reviewed annually and corporate governance arrangements in place, including those relating to compliance with relevant laws and regulations, are regularly assessed by senior officers. The AGS must be approved by the Corporate Management Team and the Audit Committee.

The Council's Monitoring Officer, the Head of Legal and Democratic Services, is generally responsible for ensuring that all laws and regulations impacting on County Services are disseminated to appropriate service managers and will arrange to brief the Corporate Management Team and Cabinet as considered appropriate on legal issues. Service managers are responsible for ensuring that laws and regulations relevant to their service area are complied with and for ensuring that any legal implications are identified and considered when any reports requiring key decisions are presented to Cabinet.

The Council's Financial Procedure Rules, which are also part of the Council's Constitution, provide the framework for managing the Council's financial affairs. There is specific provision within these procedures for the Chief Financial Officer to report to full Council, and to the Council's external auditors, if the Council or one of its officers:

- Has made, or is about to make a decision which involves incurring expenditure which is unlawful
- Has taken or is about to take any unlawful action which has resulted in a loss or deficiency to the Council
- Is about to make an unlawful entry in the Council's accounts.

I am not aware of any such issue having being reported.

Assurance that risks around compliance with laws and regulations are being effectively managed is provided through the Council's risk management processes. Independent assurance that expected internal controls, devised to manage those risks, are operating effectively is provided through the work of Internal Audit. Some external assurance is also provided through external inspection and review bodies.

9. Are management aware of any instances where the Council has not complied with any laws or regulations?

I am not aware of any instances where the Council has not complied with any laws or regulations.

ISA+501 - Litigation and claims that would effect the financial statements

10. Are management aware of any litigation or claims involving the Council which may result in a material misstatement of the financial statements?

I am not aware of any litigation or claim involving the Council which may result in a material misstatement of the 2010/11 financial statements.

Yours sincerely

D. McLure
Corporate Director Resources