

Contact: Corporate Director Resources  
Direct Tel: 03000 261943  
email: don.mclure@durham.gov.uk  
Our ref: DM/PC



Catherine Banks  
Senior Manager  
Mazars LLP  
The Rivergreen Centre  
Aykley Heads  
Durham  
DH1 5TS

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Dear Catherine

**Audit of Durham County Council's Financial Statements 2014/15 including the Pension Fund Accounts – Compliance with International Auditing Standards**

Thank you for your letter dated 11 June 2015. Please find below my responses to the questions that you have asked.

**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.***
  - a) ***How does management undertake its 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)?***

Management's assessment of the risk that the financial statements may be misstated due to fraud or error is informed by consideration of various sources of assurance on the adequacy of the control environment relating to key financial systems.

Sources of assurance include front line service managers' supervisory controls, corporate risk management arrangements and performance management arrangements.

Internal Audit review key financial systems on an annual basis, using a risk based approach, to provide independent assurance that expected controls are effective in reducing the likelihood of material fraud error. Internal Audit will also consider financial risks as part of planned assurance reviews of key service activities agreed within the annual Internal Audit plan. The risk based approach used by Internal Audit involves working with service managers to agree and assess key risks, key controls and other assurance sources using a Control Risk Assessment (CRA) methodology. This enables Internal Audit resources to be targeted to high risk areas where there is little or no

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Durham County Council, County Hall, Durham DH1 5UE  
Main Telephone 03000 26 0000 Minicom (0191) 383 3802

assurance. At the end of an audit, the CRA is updated with details of actual controls in place which provides a basis for responsible officers to carry out Control Risk Self Assessments (CRSA).

Assurance is also provided by the external auditor and other external review agencies e.g. Her Majesty's Revenues and Customs. Any agreed actions to improve the control environment are regularly monitored to ensure they are implemented in a timely manner.

Ongoing consideration of the various sources of assurance allow for continuous assessment of the risk of material misstatement. Risks will also be assessed as part of the planning and preparation of annual internal audit plans.

***b) What is management's process for identifying and responding to risks of fraud in the Council, 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?***

Managers are responsible for the implementation of controls to reduce the likelihood and / or impact of fraud occurring in their service areas.

The risk of fraud and corruption is recognised as a strategic risk and monitored through the Corporate Risk Management process.

The Chief Internal Auditor and Corporate Fraud Manager is responsible for the development and effective implementation of the Council's Counter Fraud and Corruption Strategy which has recently been refreshed and leads on a number of initiatives to help combat fraud through raising awareness of the risks, supported through a dedicated Corporate Fraud Team which in 2014/15 included Housing Benefit and Council Tax Benefit investigations. The function of investigating Housing Benefit and Council Tax Benefit Fraud transferred to Department for Work and Pensions on 1 June 2015. Fraud and corruption risks will be considered in consultation with service managers as part of the CRA process outlined above.

Internal Audit assess the fraud risk to which the Council may be exposed on an annual basis as part of the annual internal audit planning process and make provision within the annual internal audit plan for conducting a number of specific counter fraud reviews aimed to prevent and detect fraud in high risk areas. This annual assessment will consider risks identified externally such as those highlighted in the Audit Commission's publication "Protecting the Public Purse" and the National Fraud Authority's "Fighting Fraud Locally", the National Anti-Fraud Network (NAFN) and various audit/counter fraud networking groups.

The Council's Counter Fraud and Corruption Strategy is supported by a Fraud Response Plan that sets out the process to be followed if fraud is suspected.

All cases of suspected corporate fraud must be reported to the Chief Internal Auditor and Corporate Fraud Manager who will then agree, with the appropriate officers, how the matter will be investigated.

The Chief Internal Auditor keeps a register of all suspected cases of corporate fraud and monitors and reports upon counter fraud activities.

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 any monies lost will be recovered by all means available to the Council.

The investigation and outcomes of all cases of corporate fraud are monitored and reported as part of Internal Audit's quarterly progress reporting to Corporate Directors. In addition a bi-annual Protecting the Public Purse report is prepared for the consideration of Corporate Management Team summarising counter fraud initiatives, new and emerging risk, reported cases and outcomes.

Control weaknesses identified as a result of reported, suspected cases will be reviewed in consultation with service managers to reduce the impact or likelihood of the risk reoccurring. Any recommendations made to improve the control environment will be monitored by Internal Audit.

**c) *What arrangements does management have in place to communicate to employees regarding its views on business practices and ethical behaviour (for example by updating, communicating and monitoring against the Council's code of conduct)?***

The Employee Code of Conduct is part of the induction package for all new starters and is easily accessible and sign posted on the Council's Website and Intranet. It is reviewed annually and employees are regularly reminded of their responsibilities under the Code through various methods of communication e.g. Employee Updates. There is also a link to the Code of Conduct in the Counter Fraud and Corruption Strategy that is also widely communicated to employees. Support is also provided to Schools and Governors in raising fraud awareness.

More counter fraud work is planned to help embed and maintain a strong counter fraud culture across the whole Council. Improvements made during 2014/2015 include the delivery of a 'Durham Managers' counter fraud awareness training.

The monitoring of ethical behaviour will also be considered through the on-going day to day operational supervision and management of employees. The Council also has a performance management framework that includes an employee performance appraisal scheme that provides a more formal structured approach to consideration of ethical behaviour.

**d) *How does management communicate the processes for identifying and responding to fraud or error to the Audit Committee (i.e. those charged with governance)?***

Bi-annual reports are made to the Audit Committee on counter fraud activity, reported and investigated cases and outcomes.

Amendments to the Council's Counter Fraud and Corruption Strategy and Confidential Reporting Code (Whistleblowing) were reported to the Audit Committee in May 2014. The Fraud Response Plan and Anti Money Laundering Policy are expected to be reported to the Audit Committee for approval in 2015 / 2016.

New and emerging fraud risks have been brought to the Audit Committee's attention from the Audit Commission's Protecting the Public Purse briefing specifically prepared for Durham County Council. They are also informed through the annual Internal Audit plan for approval and through quarterly Internal Audit Progress reports.

**2) Does management have knowledge of any actual, suspected or alleged fraud, either within the Council as a whole or within your department during the period 1 April 2014 to 31 March 2015? If so, what actions 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 has either been disclosed through data sharing 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.

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 through bi-annual reports. New potential cases of corporate fraud will also be reported to respective Corporate Directors as and when they arise and updates provided through Internal Audit Quarterly progress reports or more frequently if necessary.

**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 always the potential for fraud to be occurring. Hence, the risk of fraud and corruption is captured within the corporate strategic risk register. However, the policies and procedures and processes outlined above and the continual development of raising fraud awareness across the organisation seek to further embed a strong counter fraud culture and minimise the risk.

Specific fraud risks within the Council are identified through the internal fraud risk assessment process. This assessment is based on the monitoring and investigation of reported cases, consideration of the overall control environment operating within the Council and national fraud risk indicators. Fraud risks will also be considered in consultation with service managers as part of the annual internal audit planning process.

Management is aware that the extent of change across the Council together with the current economic climate has increased the risk of fraud and corruption. All suspicions reported by management referred to Internal Audit are as captured in bi-annual reports to Corporate Management Team and the Audit Committee.

**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 work of Internal Audit as reported through individual audit reports, quarterly progress reports and the Annual Internal Audit Report. The latter is to be presented to Corporate Management Team and the Audit Committee in June 2015.

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 currently being prepared and will be reported to Corporate Management Team and the Audit Committee in June 2015.

**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 (Whistleblowing) that has been refreshed in May 2014 and has been effectively communicated to all employees through an employee update, induction and is easily accessible. A 'Durham Managers' Fraud Awareness Training package is now offered to reinforce managers' responsibilities in relation to fraud and encourages staff to be more vigilant and report their concerns. There are dedicated counter fraud pages on the Council's intranet that provide information to employees on how to raise any concerns and what to do and what not to do if they suspect something is wrong. Whilst employees are encouraged to report any concerns initially through their line managers or Internal Audit, external contacts are also provided.

**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 the risk?***

Discussions on the risk of fraud and corruption are held with senior management as part of the consultation process on the preparation of the annual Internal Audit Plan and managers are reminded of their responsibilities for ensuring adequate controls are implemented to manage any identified risks.

Fraud awareness training developed specifically for managers will help consider fraud risks within operational areas and identify posts which are considered to be high risk and what to do about it.

Internal Audit develops an annual counter fraud programme of work, agreed by Corporate Management Team and the Audit Committee as part of their annual Internal Audit Plan, to provide independent assurance that internal controls are operation in high risk areas.

Fidelity guarantee insurance is also in place.

**7) Is management 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 such relationships and transactions?**

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.

All Members and the 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 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 conducted during 2013 / 2014.

**8) Is management aware of any entries made in the accounting records of the Council that it believes or suspects are false or intentionally misleading?**

Given the size and complexity of transactions reflected in the Council's accounting records there is always the potential for error or false accounting that could escape detection. However, internal controls and assurance on their effectiveness provides reasonable assurance that any such error would not be material.

I am not aware of specific entries that I believe are false or intentionally misleading.

**9) Are you aware of any organisational or management pressure to meet financial or operating targets?**

I am not aware of any inappropriate organisational or management pressures being applied or incentives offered to anyone to meet financial or operating targets.

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

**10) *How does management gain assurance that all relevant laws and regulations have been complied with?***

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 are in place, including those relating to compliance with relevant laws and regulations are regularly assessed by senior officers. The Annual Governance Statement is 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 Council 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.

Arrangements have been put in place within Assistant Chief Executive to prepare regular updates on new central government initiatives and consultation exercises which are circulated to senior managers as an early warning of potential new legislation and regulations.

Assurance that risks around compliance with laws and regulations are being effectively managed is provided through the Council's risk management processes.

Internal Audit carry out periodic reviews of the control framework in place for ensuring that services are kept up to date of any changes to legislation impacting on operations and carry out compliance testing.

Other functions within the Council also provide assurance on compliance e.g. Quality Assurance Audits within Children and Adult Services and Health and Safety Inspections.

Some external assurance is also provided through external inspection and review bodies.

**11) *Is management aware of any instances where the Council has not complied with any laws or regulations during 2014/15?***

I am aware of a number of cases involving actual or potential litigation action against the Council, that if proven may indicate non-compliance with legislation in a variety of subject areas. Records of all such cases are captured in a database maintained by Legal and Democratic Services as and when cases are referred to them for advice.

**12) *Has management complied with the Bribery Act 2010. What procedures are in place to ensure compliance?***

The Council has complied with the Bribery Act 2010.

The Council has incorporated the Bribery Act 2010's requirements into its Counter Fraud and Corruption Strategy which demonstrates a zero tolerance commitment to Bribery in all forms.

The Council has an Employee Code of Conduct in place which clearly communicates the responsibilities of staff and requires officers to complete gifts and hospitality registers where appropriate.

The Council has a member's Code of Conduct in place which clearly communicates the responsibilities of members, and requires members to complete gifts and hospitality registers where appropriate.

Procedures are in place for the recording, maintaining and monitoring of such registers.

Internal Audit complete independent periodic checks on the gifts and hospitality registers held within Service Groupings.

The Council conducts its recruitment practices in fair and transparent manner. This avoids risks in the recruitment process that could lead to unsuitable candidates being selected. The Council applies objective criteria for advertising and interviewing, and documents the application and the selection process. Appropriate due diligence is applied when appointing employees who are likely to be placed in any position of risk from bribery. New employees receive full information about the Council's Counter Fraud and Corruption Strategy and this forms part of induction training. Internal Audit also completes a periodic review of the Council's recruitment process to give independent assurance.

The Council gives substance to its zero tolerance approach of bribery through its agreed proactive fraud plan compiled as part of the Annual Internal Audit Plan.



### **ISA 501 Litigation and claims that would effect the financial statements**

- 13) *Is management aware of any actual or potential litigation or claims involving the Council which may result in a material misstatement of the financial statements***

The value of individual potential claims is captured in the central database maintained by Legal and Democratic Services. Arrangements have been put in place for monitoring and reporting financial risks associated with all potential claims to ensure that any uninsured risks are appropriately reflected in the financial statements and any incidences of non-compliance with legal requirements are identified and corrective action is taken to avoid a reoccurrence. Any individual cases with a significant value are brought to the attention of the appropriate Corporate Director and Corporate Director, Resources.

These arrangements are subject to periodic independent assurance reviews by Internal Audit.

Collectively, potential values are not considered to be material although I am aware of some cases where a contingent liability and / or provision may be necessary and these will be detailed in the Statement of Accounts 2014/15.

### **ISA 550 Identification and assessment of the risks of material misstatement associated with related party relationships and transactions**

- 14) *What controls does the Council have in place to identify, authorise, approve, account for and disclose related party transactions and relationships? For any new related parties (not disclosed in 2013/14 audited financial statements) please provide a list of them, explain the nature of these and whether you have entered into any transactions with these related parties during the year to 31 March 2015***

The controls in place are those outlined in response to question 7 above.

A list is being prepared of all related party transaction, with an explanation of the nature of these and whether any transactions have been entered into with these related parties during 2014/15.

### **ISA 570 Consideration of the going concern assumption in an audit of financial statements**

- 15) *How has management assessed and satisfied itself that it is appropriate to adopt the going concern basis in preparing the financial statements?***

A full assessment has been carried out and the outcomes reported to the Audit Committee at its meeting on 29 June 2015. Based on the assessment undertaken I have concluded

that the County Council is a going concern and it is appropriate for the Statement of Accounts to be prepared on this basis because:

- The County Council has a history of stable finance and ready access to financial resources in the future.
- There are no significant, operating or other risks that would jeopardise the County Council's continuing operation.

**16) Has management 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?**

No events or conditions have occurred since the assessment to cast significant doubt on the organisation's ability to continue as a going concern.

I hope this response is satisfactory however if you have any further questions or comments on the content of this letter please do not hesitate to contact me.

Yours sincerely



Don McLure  
Corporate Director of Resources