

Councillor Bell
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Dear Cllr Bell

Durham County Council (including the Pension Fund) 2014/15

Introduction

This letter aims to summarise for the Audit Committee the requirements under International Auditing Standards (UK and Ireland) in respect of preventing fraud in the annual accounts, and compliance with laws and regulations, litigation and claims, going concern and related parties. It sets out the information we will require from the Audit Committee before we give our opinion on the Durham County Council's 2014/15 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 ISA240. 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 2014/15?
- 3) Has the Audit Committee knowledge of any actual, suspected or alleged fraud during the period 1 April 2014 – 31 March 2015?
- 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 'yes', please provide details. If not:
 - where are the risk areas?
 - what other controls are in place to help prevent, deter or detect fraud?
- 6) How do you encourage staff to report their concerns about fraud and what concerns about fraud are staff 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 does the Audit Committee mitigate the risks associated with fraud related to related party relationships and transactions?

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 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. 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 of 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 ISA570. 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?

International Standard for Auditing (UK and Ireland) 550 – Related parties

Background

The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. For example:

- Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
- Information systems may be ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.
- Related party transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration.

Because related parties are not independent of each other, many financial reporting frameworks establish specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and actual or potential effects on the financial statements. An understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether one or more fraud risk factors are present as required by ISA (UK and Ireland) 240, because fraud may be more easily committed through related parties.

What are we required to do?

Where the applicable financial reporting framework establishes requirements for 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:

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

16) 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
- 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 inform our understanding of the Council and its business processes, and to enable an opinion to be given on your 2014/15 financial statements.

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

Yours sincerely

Catherine Banks
Senior Manager