



**DRAFT**

This version of the report is a draft. Its contents and subject matter remain under review and its contents may change and be expanded as part of the finalisation of the report.

# Informing the audit risk assessment for Derby City Council

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**Year ended 31<sup>st</sup> March 2013**

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## Purpose

The purpose of this report is to contribute towards the effective two-way communication between auditors and the Council's Audit Committee, as 'those charged with governance'. The report covers some important areas of the auditor risk assessment where we are required to make inquiries of the Audit Committee under auditing standards.

### Background

Under International Standards on Auditing (UK and Ireland) (ISA(UK&I)) auditors have specific responsibilities to communicate with the Audit Committee. ISA(UK&I) emphasise the importance of two-way communication between the auditor and the Audit Committee and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Audit Committee in understanding matters relating to the audit and developing a constructive working relationship. It also enables the auditor to obtain information relevant to the audit from the Audit Committee and supports the Audit Committee in fulfilling its responsibilities in relation to the financial reporting process.

### Communication

As part of our risk assessment procedures we are required to obtain an understanding of management processes and the Audit Committee's oversight of the following areas:

- fraud
- laws and regulations
- going concern.

This report includes a series of questions on each of these areas and the response we have received from Council's management. The Audit Committee should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.

# Fraud

## Issue

### Matters in relation to fraud

ISA(UK&I)240 covers auditors responsibilities relating to fraud in an audit of financial statements.

The primary responsibility to prevent and detect fraud rests with both the Audit Committee and management. Management, with the oversight of the Audit Committee, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of its oversight, the Audit Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error. We are required to maintain professional scepticism throughout the audit, considering the potential for management override of controls.

As part of our audit risk assessment procedures we are required to consider risks of fraud. This includes considering the arrangements management has put in place with regard to fraud risks including:

- assessment that the financial statements could be materially misstated due to fraud
- process for identifying and responding to risks of fraud, including any identified specific risks
- communication with the Audit Committee regarding its processes for identifying and responding to risks of fraud
- communication to employees regarding business practices and ethical behaviour.

We need to understand how the Audit Committee oversees the above processes. We are also required to make inquiries of both management and the Audit Committee as to their knowledge of any actual, suspected or alleged fraud. These areas have been set out in the fraud risk assessment questions below together with responses from the Council's management.

## Fraud risk assessment

Question	Management response
<p>Has the Council assessed the risk of material misstatement in the financial statements due to fraud? What are the results of this process?</p>	<p>Although there is an ongoing risk of fraud being committed against the Council arrangements are in place to both prevent and detect fraud. These include work carried out by Internal Audit on overall fraud risk areas, on Council Tax and Housing Benefit fraud. The risk of material misstatement of the accounts due to undetected fraud is low.</p>
<p>What processes does the Council have in place to identify and respond to risks of fraud?</p>	<p>The Corporate Anti-Fraud Group address issues around fraud raised by the Audit Commission, NFI and other external organisations. All activities are reported back to members by Richard Boneham (Head of Governance and Assurance) in the Governance Update reports presented to Audit Committee.</p>
<p>Have any specific fraud risks, or areas with a high risk of fraud, been identified and what has been done to mitigate these risks?</p>	<p>There are some areas that are inherently at risk from fraud such as:</p> <ul style="list-style-type: none"> <li>•Council Tax</li> <li>•Benefit fraud</li> <li>•Single person discount</li> <li>•Social Housing Tenancy fraud</li> </ul> <p>The Council in response to these risks, actively participate in the Audit Commission's NFI data matching exercise. Internal audit also performs internal data matching.</p>
<p>Are internal controls, including segregation of duties, in place and operating effectively? If not, where are the risk areas and what mitigating actions have been taken?</p>	<p>Yes – Internal audit include fraud risks in their planning process and act as an effective internal control against fraud. The Head of Internal Audit's overall opinion for 2011/12 was that there is an acceptable level of internal control within the Council's systems and procedures.</p>
<p>Are there any areas where there is a potential for override of controls or inappropriate influence over the financial reporting process (for example because of undue pressure to achieve financial targets)?</p>	<p>None that have come to light during internal audit reviews.</p>
<p>Are there any areas where there is a potential for misreporting override of controls or inappropriate influence over the financial reporting process?</p>	<p>None that have come to light during internal audit reviews.</p>

## Fraud risk assessment

Question	Management response
<p>How does the Audit Committee exercise oversight over management's processes for identifying and responding to risks of fraud? What arrangements are in place to report fraud issues and risks to the Audit Committee?</p>	<p>Internal Audit provide the Audit Committee with updates of their work on fraud prevention and detection, including any significant identified frauds and the action taken. Members of the Audit Committee challenge management where significant risks are identified in Internal Audit reports.</p>
<p>How does the Council communicate and encourage ethical behaviour of its staff and contractors?</p>	<p>There is a Anti Fraud &amp; Corruption Policy and a Fraud Response plan in place which explain the procedures to follow.</p>
<p>How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?</p>	<p>There is a Fraud Response Plan which outlines the procedures to follow if officers become aware of fraud at the Council.</p>
<p>Are you aware of any related party relationships or transactions that could give rise to risks of fraud?</p>	<p>No.</p>
<p>Are you aware of any instances of actual, suspected or alleged, fraud, either within the Council as a whole or within specific departments since 1 April 2012?</p>	<p>There are no material instances of fraud that have been identified during the year.</p>

## Laws and regulations

### Issue

#### Matters in relation to laws and regulations

ISA(UK&I)250 requires us to consider the impact of laws and regulations in an audit of the financial statements.

Management, with the oversight of the Audit Committee, is responsible for ensuring that the Council's operations are conducted in accordance with laws and regulations including those that determine amounts in the financial statements.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error, taking into account the appropriate legal and regulatory framework. As part of our risk assessment procedures we are required to make inquiries of management and the Audit Committee as to whether the entity is in compliance with laws and regulations. Where we become aware of information of non-compliance or suspected non-compliance we need to gain an understanding of the non-compliance and the possible effect on the financial statements.

Risk assessment questions have been set out below together with responses from management.



## Impact of Laws and regulations

Question	Management response
What arrangements does the Council have in place to prevent and detect non-compliance with laws and regulations?	We have a suite of internal policies and procedures such as anti-bribery policy, anti-money laundering policy etc.
How does management gain assurance that all relevant laws and regulations have been complied with?	Internal audit review adherence to regulations. The Monitoring officer reviews compliance with the Council's Constitution.
How is the Audit Committee provided with assurance that all relevant laws and regulations have been complied with?	<p>The Head of Governance and Assurance provides an update to the Committee about compliance and risk.</p> <p>The s151 officer is responsible for preparing the accounting statements in accordance with the relevant legal and regulatory requirements.</p> <p>The Monitoring Officer (or representative) attends Audit Committee meetings and advises members on any areas of concern.</p>
Have there been any instances of non-compliance or suspected non-compliance with law and regulation since 1 April 2012, or earlier with an on-going impact on the 2012/13 financial statements?	None
What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?	<p>Legal Services assess litigation claims in close conjunction with Resources. Monitoring Officer and s151 officer are involved at key stages. Accounting procedure is to follow Code of Practice / IFRS requirements in assessing nature of any recognisable liability.</p> <p>Constitutionally the power to initiate and defend proceedings in the Council's name is divested in the Director of legal and Democratic Services (the Monitoring Officer), in turn their powers are delegated to lawyers within the service who undertake critical evidence and merit assessments in every case.</p> <p>The status of insurance claims are reviewed annually as part of closedown procedures.</p>
Is there any actual or potential litigation or claims that would affect the financial statements?	None at the date of these responses.
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	None

## Going Concern

### Issue

#### **Matters in relation to laws and regulations**

ISA(UK&I)570 covers auditor responsibilities in the audit of financial statements relating to management's use of the going concern assumption in the financial statements.

The going concern assumption is a fundamental principle in the preparation of financial statements. Under this assumption entities are viewed as continuing in business for the foreseeable future. Assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

The code of practice on local authority accounting requires an authority's financial statements to be prepared on a going concern basis. Although the Council is not subject to the same future trading uncertainties as private sector entities, consideration of the key features of the going concern provides an indication of the Council's financial resilience.

As auditor, we are responsible for considering the appropriateness of use of the going concern assumption in preparing the financial statements and to consider whether there are material uncertainties about the Council's ability to continue as a going concern that need to be disclosed in the financial statements. We discuss the going concern assumption with management and review the Council's financial and operating performance.

Going concern considerations have been set out below and management has provided its response.

## Going Concern Considerations

Question	Management response
Does the Council have procedures in place to assess the Council's ability to continue as a going concern?	<p>The Local Authority is underwritten by the Secretary of State and as such continues as a going concern until unless there "is an intention by government that the services provided by the authority will no longer be provided".</p> <p>The implications of material changes to legislation, statute and funding are continually reviewed and reported to cabinet in monthly monitoring and cabinet on a quarterly basis.</p>
Is management aware of the existence of other events or conditions that may cast doubt on the Council's ability to continue as a going concern?	No. The Council has recently set a 3 year balanced budget.
Are arrangements in place to report the going concern assessment to the Audit Committee?	Yes – The Going Concern assessment is presented within the Statement of Accounts to Audit and Accounts Committee.
Are the implications of statutory or policy changes appropriately reflected in the Business Plan and financial forecasts?	Yes - All known material changes have been reflected in the medium term financial plan.
Have there been any significant issues raised with the Audit Committee during the year which could cast doubts on the Council's ability to continue as a going concern ? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).	No

## Going Concern Considerations

Question	Management response
<p>Does a review of available financial information identify any adverse financial indicators including negative cash flow? If so, what action is being taken to improve financial performance?</p>	<p>No</p>
<p>Does the Council have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Council's objectives? If not, what action is being taken to obtain those skills?</p>	<p>The Council Objectives and business plans are set according to the Councils available resources.</p>



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