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To: Governance and Audit Committee – 29th April 2015

Subject: **Fraud, Law and Regulations and Going Concern Considerations**

Classification: Unrestricted

Summary: The attached questionnaire from Grant Thornton summarises management's responses to questions on the Council's processes in relation to fraud, law and regulations and going concern risks.

FOR DECISION

Introduction

1. Under International Standards on Auditing (UK and Ireland) (ISA(UK&I)) auditors have specific responsibilities to communicate with the Governance and Audit Committee (G&AC). ISA (UK&I) emphasise the importance of two-way communication between the auditor and the G&AC and also specify matters that should be communicated.
2. This two way communication enables the auditor to obtain information relevant to the audit from the G&AC and supports the G&AC in fulfilling its responsibilities in relation to the financial reporting process.

Purpose of Report

3. As part of Grant Thornton's risk assessment procedures they are required to obtain an understanding of management processes and the G&AC oversight of the following areas:
 - Fraud
 - Laws and regulations
 - Going concern
4. The attached report includes a series of questions on each of these areas and the response we have provided to Grant Thornton. Although incorporated into a Grant Thornton report and layout, these are responses from KCC management.
5. The G&AC should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.

Recommendation

6. Members are asked to comment on the responses to Grant Thornton's questions and approve the management responses provided.

Andy Wood

Corporate Director of Finance and Procurement

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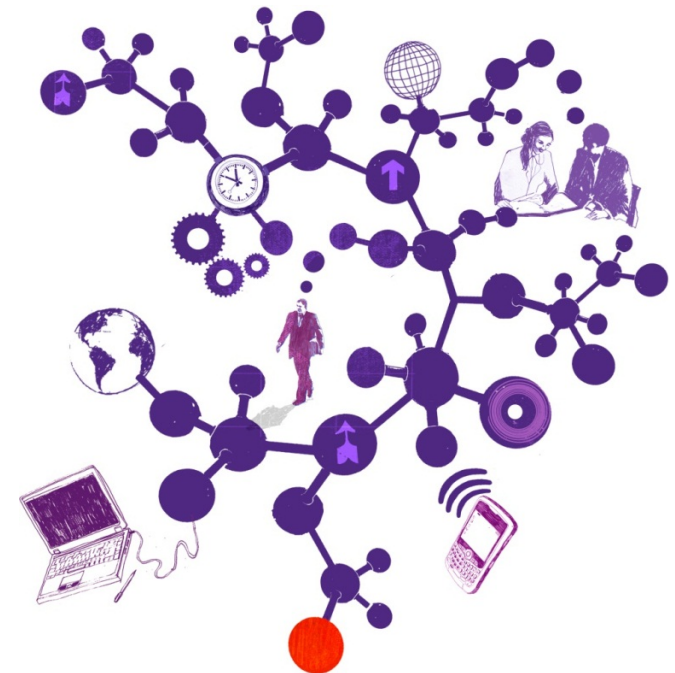
Informing the audit risk assessment for Kent County Council and Kent Pension Fund

Year ended 31 March 2015

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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 Governance and 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 Governance and 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 Governance and Audit Committee. ISA(UK&I) emphasise the importance of two-way communication between the auditor and the Governance and Audit Committee and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Governance and 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 Governance and Audit Committee and supports the Governance and 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 Governance and 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 the Council's management. The Governance and Audit Committee should consider whether these responses are consistent with the 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 Governance and Audit Committee and management. Management, with the oversight of the Governance and 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 Governance and 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 Governance and 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 Governance and Audit Committee oversees the above processes. We are also required to make inquiries of both management and the Governance and 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>The risk is minimal. Controls are in place through the budget setting, budget monitoring and year-end analytical review. Changes implemented last year to identify owners of cost centres mean we can target and challenge any budget manager where we perceive there may be anomalies. We also have a regular balance sheet management review. Any variance from budget of £0.1m or more must be explained and validated. Significant changes from previous year's spend must also be explained.</p>
<p>What processes does the Council have in place to identify and respond to risks of fraud?</p>	<p>The council has key policies and procedures in place which includes a code of conduct, whistleblowing, anti-fraud and corruption and anti-bribery.</p> <p>The council has a dedicated fraud team within internal audit who promote an anti-fraud culture. In 14/15 the fraud team ran an anti-fraud campaign called 'Spot it, Stop it' which provide advice to staff on what to do if they suspect fraud including how to report it.</p> <p>In addition, the team undertakes proactive reviews of areas that might be susceptible to fraud and recommends improvements in controls if weaknesses are identified.</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>The council's whistleblowing arrangements continue to be effective and in 14/15 have been strengthened through a fraud awareness campaign. This has resulted in an increase of detected fraud. Where control weaknesses have been identified these have been addressed and the results reported to management and the Governance and Audit Committee.</p>

Fraud risk assessment

Question	Management response
<p>Are internal controls, including segregation of duties, in place and operating effectively?</p> <p>If not, where are the risk areas and what mitigating actions have been taken?</p>	<p>Generally internal controls are operating effectively. Where weaknesses have been identified these have been addressed by management. In addition, Corporate Directors will be required to submit their supporting statements for the Annual Governance Statement.</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>Yes, this is a risk applicable to any budget manager, as their performance against budget is a factor in their annual performance assessment. However, this is a relatively minor risk and is mitigated by the monthly budget monitoring and year end processes, as well as setting realistic budgets to start with. The creation of KCC Companies does increase risk and appropriate controls / governance are being put in place.</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>For all significant areas of activity, we have the internal management controls of supervision, exception reporting, Performance Evaluation Board, etc as well as the independence of the Internal Audit team, along with the absolute independence of the Head of Audit.</p>

Fraud risk assessment

Question	Management response
<p>How does the Governance and Audit Committee exercise oversight over management's processes for identifying and responding to risks of fraud?</p> <p>What arrangements are in place to report fraud issues and risks to the Governance and Audit Committee?</p> <p>How has the Council ensured that the Governance and Audit Committee are made aware of whistleblower tips or complaints?</p>	<p>The Committee has agreed and monitors the annual internal audit plan that provides assurance in relation to the management of the significant risks faced by the Council (including fraud risk), and also provides assurance on the risk management and governance frameworks put in place by management. This is reported via quarterly reports and an annual report that provides key themes of areas where internal control may need improving. The Committee has received quarterly progress reports from Internal Audit which includes details of frauds and irregularities and lapses or breaches of internal control. Grant Thornton has access to the same information through the published papers of the Committee.</p> <p>There remain cases that are still subject to investigation which have yet to be reported. The Head of Internal Audit has provided assurance that the circumstances of these cases would not be considered significant, although until the investigations are complete this cannot be guaranteed. The Committee receives, requests and assesses ad-hoc and routine assurance reports on:</p> <ul style="list-style-type: none"> Complaints (including those referred to the Ombudsman) Surveillance activities Debt recovery and management Treasury management Insurance activities <p>In July 2015, the Committee will be asked to review the Annual Governance Statement of the Council. This process will include consideration of the Council's ability to identify and manage risks and a consideration of the overall internal control environment. The Internal Audit team have a systematic process that captures all tip-offs, records action taken, and concludes with a report to management and if significant the Governance and Audit Committee.</p>

Fraud risk assessment

Question	Management response
<p>How does the Council communicate and encourage ethical behaviour of its staff and contractors?</p>	<p>The council has a suite of policies and processes in place to communicate and encourage ethical behaviour from its staff and contractors including (but not limited to) the:</p> <ul style="list-style-type: none"> Kent Code Bribery Act Policy Anti-Fraud and Corruption Policy Whistleblowing Policy <p>These policies are available for all staff to view on Knet. They are signposted to new staff during their induction. There are also regular reminders issued via Kmail.</p> <p>In addition, the fraud team delivered a fraud awareness campaign called 'Spot it, Stop it' which promoted ethical behaviour.</p>
<p>How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?</p>	<p>Staff are encouraged to report concerns of fraud through the council's policies and its management. The fraud team also encourage staff to report concerns through a programme of fraud awareness activity. The team also promotes and manages the whistleblowing helpline.</p> <p>In 2014/15 the fraud team delivered a fraud awareness campaign called 'Spot it, Stop it' which encouraged staff to report any concerns of fraud and wrongdoing.</p>
<p>Are you aware of any related party relationships or transactions that could give rise to risks of fraud?</p>	<p>No. Employees and Members are required to declare any conflicts of interests as well as any gifts and hospitalities.</p> <p>The annual proactive data match between Companies House and KCC records revealed some undeclared interests but no fraud or related party transactions were identified.</p>

Fraud risk assessment

Question	Management response
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 2014?	Yes. Management and the Governance and Audit Committee have been informed of a number of allegations. Any requiring investigation following preliminary enquiries, have been investigated. Some incidents have been referred to the Police or Trading Standards. A number of staff have been subject to disciplinary sanctions and members of the public have received cautions or warning letters.

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 Governance and 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 Governance and 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?	Internal Audit, Democratic Services, Legal Services and the Procurement team work closely with Directorates to ensure compliance with EU procurement laws.
How does management gain assurance that all relevant laws and regulations have been complied with?	As above, plus 1:1 supervision between managers and their direct reports, plus the Corporate Directors AGS, as well as external reviews e.g. OFSTED.
How is the Governance and Audit Committee provided with assurance that all relevant laws and regulations have been complied with?	<p>The Governance and Law division is responsible for ensuring that the Council correctly applies the law and regulations governing its business. The department is led by the Director of Governance and Law, who is also the Council's Monitoring Officer and, as part of the process to support the Annual Governance Statement, has submitted a statement of assurance with regard to his statutory duties.</p> <p>The Director of Governance and Law attended all meetings of the Governance and Audit Committee, and would make the Committee aware of any significant possible instances of non-compliance with laws and regulations. In addition, the Head of Internal Audit would also report any known significant instances of non-compliance with laws and regulations. Internal Audit has reported on instances of non-compliance with relevant laws and regulations within their quarterly reports.</p>
Have there been any instances of non-compliance or suspected non-compliance with law and regulation since 1 April 2014, or earlier with an on-going impact on the 2014/15 financial statements?	None that we are aware of.

Impact of law and regulations

Question	Management response
What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?	The Chief Accountant liaises with Legal Services team to capture all potential claims. Legal estimate the potential 'loss' as best they can. This is then reported to this Committee through the Statement of Accounts in July.
Is there any actual or potential litigation or claims that would affect the financial statements?	Not at this stage, but this will be kept under review throughout the Closedown process.
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	No.

Going concern

Issue

Matters in relation to going concern

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.

The consideration of the going concern assumption is becoming of greater relevance to local authority financial statements. All councils are facing significant pressures to balance future budgets as the funding from central government continues to reduce. There is a risk, particularly in smaller local authorities, that services will no longer be provided in the way they have historically been delivered. There is an increasing vulnerability of these bodies as a going concern.

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?	This assessment is carried out by the S151 officer on an ongoing basis but especially at the time of setting the budget and producing Final Accounts.
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?	None in the short-medium term.
Has management reported on going concern to the Governance and Audit Committee? (if not, what arrangements are in place to report the going concern assessment to the Governance and Audit Committee?)	This is reported through the S151 officer certification within the Statement of Accounts, and through his Section 25 Assurance on County Council Budget day.
Are the financial assumptions in that report (eg future levels of income and expenditure) consistent with the Council's Business Plan and the financial information provided to the Council throughout the year?	N/A

Going concern considerations

Question	Management response
Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	Yes, including in the Medium Term Financial Plan.
Have there been any significant issues raised with the Governance and Audit Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).	No.
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?	No.
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?	The Council is continually changing in line with its transformation agenda. This will undoubtedly result in a reducing number of senior managers. However, this is recognised and the risks are mitigated through effective training and succession planning.



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