

25 June 2012

Dear Mrs Blatcher

### **Response of the Chair of the Audit Committee to the Audit Commission's request for information to support its compliance with International Standards on Auditing**

The Audit Committee and I have considered your request for information to enable you to comply with International Standards on Auditing and the Committee has approved the following response.

#### **1. Your requirements**

1.1 The Audit Commission is obliged to comply with International Standards on Auditing. In particular it is required to gain an understanding of how the Audit Committee exercises oversight of management's processes in respect of both Lancashire County Council and the Lancashire Pension Fund in relation to:

- fraud and internal control;
- laws and regulations;
- litigation and claims; and
- going concern.

#### **2. The role of the Audit Committee**

2.1 Under its terms of reference the Audit Committee advises the council on risk, control and governance, oversees the planned activity and results of both internal and external audit, and considers the adequacy of management's responses to issues identified by audit activity. It therefore oversees the work of the council's Internal Audit Service, which provides assurance to the council on the adequacy and effectiveness of its internal controls, including financial controls, and also supports the council in its management of the risk of fraud by providing a counter fraud and investigatory service.

2.2 Since fraud represents a lapse in financial control, the Audit Committee is also charged with responsibility for overseeing management's arrangements in response to the risk of fraud. However, during 2011/12 the Standards Committee has been charged with governance in this area and its work too is considered in this response.

2.3 In an organisation of Lancashire County Council's size, a proportional approach must be taken to an assessment of risk and to the assurance required over the controls implemented to manage it. It is impractical to expect that either a committee of elected members or the Internal Audit Service, having adopted a risk-based approach, will be able to oversee and assess all management processes. Nor can absolute assurance be gained that compliance with all applicable laws and regulations is achieved.

### **3. The Audit Committee's oversight of internal audit work**

- 3.1 The Audit Committee approves the annual internal audit plan, which is based on an assessment of the council's risks and the operational and financial controls that mitigate these. The annual audit plan also refers to the Internal Audit Service's work to support management in managing the risk of fraud and sets aside audit resources for the investigation of suspected or alleged instances of fraud. It too is built upon an assessment of risk that includes the risk of non-compliance with relevant laws and regulations.
- 3.2 The Audit Committee receives regular progress reports from the head of internal audit, and the Standards Committee has received regular reports on the council's counter fraud arrangements, including reports on breaches of internal control and fraud risks. The deputy county treasurer briefs the Audit Committee on financial matters, and other officers attend to brief the Audit Committee on control issues as necessary to respond to audit reports and inform the committee of progress where remedial action has been agreed.
- 3.3 The council's Internal Audit Service operates a proactive programme to identify and pursue indications of fraudulent activity in particular within the council's key financial systems, regularly testing both the corporate controls and controls operated within individual services. Computer assisted techniques and additional testing of areas susceptible to fraud have been developed to enable the Internal Audit Service proactively to assess whether there are indications of malpractice in key areas.
- 3.4 As the Audit Commission will be aware, the council actively participates in its National Fraud Initiative which serves as a regular extension of the work done by the Internal Audit Service throughout the year. Checks are carried out on the reports raised by this initiative and support is also given to the Lancashire districts.
- 3.5 The Internal Audit Service services the financial whistle-blowing helpline and regularly responds both to formal whistle-blowing calls and to less formal concerns raised with individual auditors by staff across the council. Investigations are undertaken promptly and pursued vigorously and, where appropriate, there is good liaison with the police.
- 3.6 The Audit Committee and the Pension Fund Committee have been provided with the head of internal audit's annual plans and reports to Lancashire County Council and the Lancashire Pension Fund respectively, and these reports have also been shared with the Audit Commission.
- 3.7 Both management and the Audit Committee are aware of the Audit Commission's assessment of the level at which misstatements of Lancashire County Council's and Lancashire Pension Fund's financial statements are deemed to be material, and are briefed on the Commission's assessment of the risks of material misstatement of the financial statements, including the risk of fraud. Any risk of misstatement due to fraud with a potential impact of this magnitude would be highlighted immediately by the Internal Audit Service to both management and the Audit Committee.

### **4. The Audit Committee's oversight of management processes**

- 4.1 The Audit Committee takes seriously its role in reviewing Lancashire County Council's internal control effectiveness, including financial control arrangements

and compliance with the law. It values its independence of both the executive and scrutiny functions and its direct reporting line to the council. The Pension Fund Committee, rather than the Audit Committee, considers the Internal Audit Service's annual plan and annual report relating to controls over the Lancashire Pension Fund. The council's Standards Committee is charged with oversight of the overall arrangements by which the risk of fraud is managed.

- 4.2 A key element of the assurance available to the Audit Committee and to the Council is the suite of assurance statements made by each of the executive directors annually that support the annual governance statement and require each executive director to take personal responsibility for the operation of an adequate and effective control system, which includes compliance with applicable laws and regulations.
- 4.3 The Audit Committee receives information about instances of financial impropriety and fraud as well as breaches of control within the head of internal audit's regular progress reports and annual report.
- 4.4 The Standards Committee has considered the council's counter fraud arrangements and has approved a counter fraud policy statement, strategy and work-plan, and a whistle-blowing policy which have been periodically communicated to the council's staff. It receives periodic reports from the Internal Audit Service of issues being investigated as potential impropriety or fraud, and management's responses to these.

## **5. Fraud and internal control**

- 5.1 Other than the issues noted in the head of internal audit's annual report, progress reports to each of its meetings, and the year-end report on counter fraud and special investigations, the Audit Committee is unaware of any breaches of internal control within Lancashire County Council during 2011/12. The Committee has considered the existence and operation of internal controls (including, implicitly, segregation of duties) and where it has concerns, these have been minuted during the year. It has been informed that no breaches of internal control relating to Lancashire Pension Fund have been reported to the Pension Fund Committee during 2011/12.
- 5.2 Similarly, other than as reported in the Internal Audit Service's annual Counter fraud and special investigations annual report 2011/12, the Audit Committee is unaware of any actual, suspected or alleged frauds affecting either the Council or Pension Fund. Nor is the committee aware of any related party relationships or transactions that could give rise to instances of fraud in either entity.
- 5.3 The Audit Committee is not aware of any entries in the accounting records of either the Council or Pension Fund that it believes or suspects are false or intentionally misleading.

## **6. Laws and regulations**

- 6.1 As stated above in paragraph 2.3, in an organisation of the size and complexity of Lancashire County Council, absolute assurance cannot be gained that compliance with all applicable laws and regulations is achieved. The Audit Committee is not aware of any significant areas of non-compliance during 2011/12, although it has specifically considered the council's compliance with legislation relating to children educated at home.

**7. Litigation and claims**

- 7.1 The Audit Committee is unaware of any actual or potential litigation or claims against the council that would have a material impact on the financial statements.

**8. Going concern**

- 8.1 The Audit Committee has received assurance from the County Treasurer that it is appropriate to adopt the going concern basis in preparing the council's financial statements. It is not aware of any events or circumstances that cast doubt on the council's ability to continue as a going concern.

Yours sincerely

**Chair of the Audit Committee**

Lancashire County Council