

27 June 2011

Dear Mr Portman

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

The Audit Committee considered your request for information to enable you to comply with International Standards on Auditing at its meeting on 27 June 2011 and 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 those charged with governance exercise oversight of management's processes in relation to:
- Assessing the risk that the financial statements may be materially misstated due to fraud;
 - Identifying and responding to the risk of fraud in the council;
 - Communicating the council's views on business practice and ethical behaviour to employees; and
 - Communicating to those charged with governance the council's processes for identifying and responding to fraud.
- 1.2 The Audit Commission is also required to understand:
- How the Audit Committee oversees management processes to identify and respond to the risk of fraud and possible breaches of internal control;
 - Whether the Audit Committee or its chair has any knowledge of any actual, suspected or alleged frauds; and
 - How the Audit Committee gains assurance that all relevant laws and regulations have been complied with.

2. 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 the Standards Committee is 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 scale, 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 full range of operational and financial controls. Where controls to manage the risk of non-compliance with laws and regulations are assessed as significant, these are included in the annual audit plan.

3.2 The annual audit plan 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 is also built upon an assessment of risk that includes the risk of non-compliance with relevant laws and regulations.

3.3 The Audit Committee receives regular progress reports from the head of internal audit, and the Standards Committee receives regular reports on the council's counter fraud arrangements, including reports on breaches of internal control and fraud risks. The assistant director of finance (accountancy and financial services) also 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.

3.4 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.

3.5 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 promptly on the reports raised by this initiative and support is also given to the Lancashire districts.

3.6 The Internal Audit Service serves 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.

- 3.7 The Audit Committee has been provided with the annual report of the head of internal audit, and this report has also been shared with the Audit Commission.
- 3.8 Both management and the Audit Committee are aware of the Audit Commission's assessment of the level at which misstatements of the 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 its role in reviewing the effectiveness of internal control, including financial control arrangements and compliance with the law, seriously. It values its independence of both the executive and scrutiny functions and its direct reporting line to the council.
- 4.2 A key element of the assurance available to the 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 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. However it is the council's Standards Committee that is charged with oversight of the overall arrangements by which the risk of fraud is managed.
- 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.
- 4.5 A proportionate approach is taken to further awareness-raising and those members of staff exposed to the risk of fraud or impropriety are made well aware of the council's position, for example through line management's briefings.

5. Actual, suspected or alleged frauds affecting the council

- 5.1 Other than the issues noted in the head of internal audit's annual report the Audit Committee is unaware of any actual, suspected or alleged frauds affecting the council.

6. Actual or potential litigation

- 6.1 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 that will not be reported in the notes to the financial statements ('Contingent liabilities').

Yours sincerely

Chair of the Audit Committee
Lancashire County Council