

30 June 2014

Dear Mr Cross

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

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

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

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

2.1 Under its terms of reference the Audit and Governance 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 and Governance Committee is also charged with responsibility for overseeing management's arrangements in response to the risk of fraud.

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 and Governance Committee's oversight of internal audit work**

3.1 The Audit and Governance 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. It is built upon an assessment of risk that includes the risk of non-compliance with relevant laws and regulations. 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.

- 3.2 The Audit and Governance Committee receives regular progress reports from the chief internal auditor, including reports on breaches of internal control and fraud risks. The Deputy County Treasurer briefs the Audit and Governance Committee on financial matters, and other officers attend to brief the Audit and Governance 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 Grant Thornton will be aware, the council actively participates in the Audit Commission's 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 and Governance Committee has been provided with the Internal Audit Service's annual plans and reports to Lancashire County Council, and these reports have also been shared with Grant Thornton.
- 3.7 Both management and the Audit and Governance Committee are aware of Grant Thornton's assessment of the level at which misstatements of Lancashire County Council's financial statements are deemed to be material, and are briefed on the external auditor'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 and Governance Committee.

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

- 4.1 The Audit and Governance 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. It is also charged with oversight of the overall arrangements by which the risk of fraud is managed.

- 4.2 The Audit and Governance Committee receives information about instances of financial impropriety and fraud as well as breaches of control within the Internal Audit Service's regular progress reports and annual report.
- 4.3 A counter fraud policy statement, strategy and work-plan, and a whistle-blowing policy are in place and are periodically communicated to the council's staff. The Audit and Governance Committee 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 during the year in respect of procurement and governance surrounding the remuneration of senior managers within One Connect Limited, and additional issues raised in the Internal Audit Service's annual report, progress reports to each of its meetings, and the year-end report on counter fraud and special investigations, the Audit and Governance Committee is unaware of any further breaches of internal control within Lancashire County Council during 2013/14. 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.
- 5.2 Similarly, other than the exceptions indicated above, the Audit and Governance Committee is unaware of any further actual, suspected or alleged frauds, or any related party relationships or transactions that could give rise to instances of fraud affecting the council.
- 5.3 The Audit and Governance Committee is not aware of any entries in the accounting records of the Council 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 and Governance Committee is not aware of any significant areas of non-compliance during 2013/14.

## **7. Litigation and claims**

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

Yours sincerely

**Chair of the Audit and Governance Committee**  
Lancashire County Council