

CHESHIRE EAST COUNCIL

AUDIT AND GOVERNANCE COMMITTEE

Date of Meeting:	25 January 2011
Report of:	Head of Internal Audit & Compliance and Borough Treasurer and Head of Assets
Subject/Title:	Compliance with International Auditing Standards

1.0 Report Summary

- 1.1 In order to comply with International Standards on Auditing (UK and Ireland) the Council's External Auditors (Audit Commission) require an understanding of how those charged with governance exercise oversight of management's processes for identifying and reporting the risk of fraud and possible breaches of internal control in the Council (ISA 240).
- 1.2 The Audit Commission also require an understanding of how those charged with governance gain assurance that all relevant laws and regulations have been complied with (ISA 250).
- 1.3 The Audit and Governance Committee is the committee 'charged with governance' and this report has, therefore, been drafted in order to assist both the Chairman and the Borough Treasurer and Head of Assets in formally responding to the Audit Commission.

2.0 Recommendation

- 2.1 That the Committee notes (i) the content of this report and (ii) that it will form the basis of the written response to the Council's External Auditors by the Chairman of the Audit and Governance Committee and the Borough Treasurer and Head of Assets.

3.0 Reasons for Recommendations

- 3.1 The Council's officers are responsible for establishing and implementing arrangements to counter fraud and corruption and ensuring the Council's operations are conducted in accordance with laws and regulations. In order for the Council's anti fraud and compliance objectives to be achieved it is important that the Audit and Governance Committee actively oversee management arrangements including considering the potential for override of controls or other inappropriate influence over the financial reporting process.

3.2 In recognition of this important role, and in order to comply with International Standards on Auditing (UK and Ireland), the Audit Commission require an understanding of:

- management arrangements for identifying and reporting the risk of fraud and complying with relevant laws and regulations
- how the Audit and Governance Committee exercises oversight of these processes

4.0 Wards Affected

4.1 All wards.

5.0 Local Ward Members

5.1 Not applicable.

6.0 Policy Implications including - Climate change - Health

6.1 Not applicable.

7.0 Financial Implications (Authorised by the Borough Treasurer)

7.1 No specific financial implications although incidences of fraud and non compliance with the law and regulations can result in financial consequences for the Council such as fines and litigation.

8.0 Legal Implications (Authorised by the Borough Solicitor)

8.1 The responsibilities of public sector entities in relation to the prevention and detection of fraud and error are set out in statute, standards and other guidance. Local Government entities have a statutory duty to make arrangements for the proper administration of their financial affairs. An officer (Borough Treasurer and Head of Assets) must also be appointed to have responsibility for the administration of these arrangements.

8.2 In addition the Accounts and Audit Regulations require the “responsible financial officer” to determine accounting control systems that include measures to enable the prevention and detection of inaccuracies and fraud.

9.0 Risk Management

9.1 The Council as a large organisation is at risk of:

- loss due to fraud
- failure to comply with laws and regulations

Both of which may materially affect the financial statements.

- 9.2 The impact of which can have consequences that are serious and often far reaching. Financial loss is the obvious key risk but the undermining of public confidence that can result from the discovery of such issues can inflict a much greater damage than the act itself. In order to mitigate this risk Management needs to establish and implement robust arrangements that are actively overseen by those charged with governance.

10.0 Background and Options

- 10.1 The Audit Commission has requested an understanding of the following:

- 1) Management processes in relation to:
 - undertaking an assessment of the risk that the financial statements may be materially misstated due to fraud
 - identifying and responding to risks of fraud in the organisation
 - communication to employees of views on business practice and ethical behaviour
 - communication to those charged with governance the processes for identifying and responding to fraud
- 2) Management's awareness of any actual or alleged instances of fraud.
- 3) How management gain assurance that all relevant laws and regulations have been complied with.
- 4) Whether there is any potential litigation or claims that would affect the financial statements.

- 10.2 Management's response to the external auditor's request for information can be found at Appendix A.

11.0 Access to Information

The background papers relating to this report can be inspected by contacting the report writer:

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1.0 Management Processes

Undertaking an assessment of the risk that the financial statements may be materially mis-stated due to fraud

- 1.1 The Council's risk management process has identified the "Risk that the Council fails to manage expenditure within budget and maintain an adequate level of reserves, thereby threatening financial stability and service continuity and preventing the achievement of corporate objectives" as a Strategic Risk. This risk recognizes that the Council could be exposed to losses or unplanned expenditure, as a result of the misappropriation of assets and/or fraudulent financial reporting as well as other causes/triggers. Following the identification and assessment of mitigating controls the risk has been measured as high with planned actions reducing the risk to a medium.
- 1.2 The full Internal Audit Plan for 2010/11 is designed to allow Internal Audit to offer an opinion on the adequacy and effectiveness of the Council's risk management, control and governance processes. The plan has been developed using the following areas of audit activity:
- Supporting Corporate Governance
 - Core Financial and Fundamental Systems
 - Key Service and Departmental Systems
 - Counter Fraud and Probity
 - Value for Money/Strategic Reviews

The remaining audit time is allocated to follow up and responsive work.

- 1.3 A programme of audits has been/is being carried out in accordance with the plan that was approved by the Governance and Constitution Committee in May 2010.
- 1.4 The work includes the Council's fundamental financial systems in order to gain assurance that the systems of financial control are in place and operating effectively. The fundamental systems (those that could give rise to material mis-statements) and key controls have been agreed with External Audit in order that they may rely on the work of internal audit. Internal Audit continues to undertake testing (examining whether the control has operated effectively throughout 2010/11) on the controls. In this way Management can get reasonable assurance with regard to the potential for override of management controls or other inappropriate influence over the financial reporting process.
- 1.5 As part of the Annual Governance Statement process for 2010/11 the Directors, Heads of Service and Managers will be required to sign off on the adequacy of controls within their service areas/directorate via disclosure statements.

Identifying and responding to risks of fraud in the organization

- 1.6 The Council ensures that the standards of conduct expected of staff are defined and communicated through, for example, Codes of Conduct, an anti-fraud and corruption policy and the whistleblowing policy. Such policies, together with the Councils Constitution, prescribe the arrangements that ensure suspected cases of fraud and corruption are reported promptly to the appropriate person for further investigation.
- 1.7 The Council's anti fraud and corruption strategy states that Cheshire East Council's members and employees are positively encouraged to raise concerns regarding fraud and corruption, immaterial of seniority, rank or status, in the knowledge that such concerns will be taken seriously and wherever possible, treated in confidence and properly investigated.
- 1.8 Concerns must be raised when members or employees reasonably believe that one or more of the following has occurred, is in the process of occurring, or is likely to occur:
- a criminal offence
 - a failure to comply with a statutory or legal obligation
 - improper and/or unauthorised use of public or other funds
 - a miscarriage of justice
 - maladministration, misconduct or malpractice
 - endangering of an individual's health and safety
 - damage to the environment
 - deliberate concealment of any of the above.
- 1.9 Concerns must be raised firstly with the supervisor/line manager or, where a person feels unable to do this, via other routes, for example:-
- Heads of Service, Directors, or the Chief Executive, who will report such concerns to the Internal Audit Manager or their authorised representative.
 - Directly to the Internal Audit Manager or a senior member of the internal audit team
 - The External Auditor, who depending upon the nature of the concern will liaise with the Internal Audit Manager or Borough Treasurer and Head of Assets (as Section 151 officer)
 - The Monitoring Officer as outlined in the Confidential Reporting (or Whistleblowing Protocol)
 - The Customer, compliments, Comments & Complaints procedure for use by the general public.
- 1.10 Partners, contractors, consultants, suppliers, service users, employees and committee members of organisations which the Borough Council funds and the general public are also encouraged to report concerns through any of the above routes.
- 1.11 The Council ensures that any allegations received in any way, including by anonymous letters or telephone calls are taken seriously and investigated in an appropriate manner.

- 1.12 Under the National Fraud Initiative (NFI) the Council supplies sets of data from information systems such as benefits, pay and pensions and suppliers. NFI then cross matches this data to identify potential inaccuracies and fraud which the Council then investigates.
- 1.13 Work by internal audit – See above. Furthermore, internal auditors are personally responsible for applying due professional care which includes being alert to the possibility of intentional wrongdoing, errors and omissions and failure to comply with management policy and conflicts of interest.
- 1.14 All allegations of fraud are reported to the Head of Internal Audit & Compliance even if it is not necessary for internal audit to investigate. This informs the opinion on the control environment and internal audit's work programme. At the request of management internal audit may assist with the investigation of suspected fraud ensuring that any local investigations are undertaken thoroughly, consistently and impartially or by requesting assurance that management have taken action to reduce the likelihood of re-occurrence.
- 1.15 The Benefit Fraud Team is responsible for all benefit fraud investigations and prosecutions. The Benefits Anti Fraud and Corruption Strategy, which deals specifically with welfare benefits issues, is complimentary to the main Anti Fraud Strategy. The benefits service strategy is supplemented by the Benefits Fraud Sanction Policy. This policy outlines the criteria used to determine which sanctions may be applicable if a case is proven by the Investigation Team.
- 1.16 In addition to a confidential reporting procedure the benefit investigation team also operate a separate hotline, for use by members of the public. Referrals may also be made from the national fraud hotline managed by central government. These hotlines are publicised in relevant council literature as well as targeted media campaigns.
- 1.17 In line with the Anti Fraud and Corruption Strategy the Borough Solicitor will, in consultation with the appropriate Chief Officer, decide whether any matter under investigation should be recommended for referral to the Police or the appropriate enforcement agency.

Communication to employees of views on business practice and ethical behaviour

- 1.18 All employees are governed by the Council's Financial and Contract Procedure Rules. They are required to follow the standards set out in the Code of Conduct, which is issued to all staff along with their Contract of Employment. Employees are further governed by the Council's HR Policies (Disciplinary Procedure etc), which are issued to all staff. The Codes are communicated via briefings, training and are available on the Council's intranet and internet.
- 1.19 The role that employees are expected to play in the Council's framework of internal control is included in staff induction procedures

by their line manager and then subsequently through corporate induction training, as appropriate.

- 1.20 The anti fraud & corruption policy states that Cheshire East Council expects its employees to comply with codes of practice or other relevant professional obligations issued by professional bodies of which they may be members. Furthermore it reminds employees that they must comply with Section 117 of the Local Government Act 1972 which requires any interests in contracts that have been proposed to be entered into by the Council to be declared. The Legislation also prohibits the acceptance of fees or rewards other than by means of proper remuneration.
- 1.21 Employees must register any interests they may have in the departmental register recording Declarations of Interests.
- 1.22 All offers of gifts and hospitality, regardless of whether the offer was accepted or declined, must be recorded in the departmental register. Such registers are reviewed by the appropriate departmental management team on a regular basis and a record kept of such review.

Communication to those charged with governance the processes for identifying and responding to fraud

- 1.23 The Head of Internal Audit and Compliance provides a written report to the Audit & Governance Committee to support the Annual Governance Statement. The report includes an opinion on the overall adequacy and effectiveness of the Council's control environment, and a summary of the audit work from which the opinion is derived including counter fraud, probity and investigations work.
- 1.24 In addition to the annual report, the Head of Internal Audit provides the Committee with interim audit and risk management reports in the course of the year. The audit reports address emerging issues in respect of the whole range of areas to be covered in the annual report.
- 1.25 The Audit and Governance Committee work programme includes various update reports with regard to anti fraud and corruption.

2.0 Management's awareness of any actual or alleged instances of fraud

- 2.1 To monitor the success of the Anti Fraud & Corruption Strategy, the following indicators are reported to the Head of Policy and Performance on a quarterly basis:-
- Number of cases referred or identified to Internal Audit & Housing Benefit Investigation Teams
 - Number of cases in which fraud/corruption was proved
 - Value (£) of misappropriation

- Number and type of benefit fraud sanctions
- Number of employees disciplined for offences of fraud and corruption

2.2 From the work undertaken by internal audit during 2010/11, there is no evidence to suggest any impact on the 2010/11 Financial Statements.

3.0 How management gain assurance that all relevant laws and regulations have been complied with.

3.1 The Council has in place, within the Constitution, various procedure rules which set out how budget and policy decisions are made. Officers are required to ensure that compliance with relevant laws and regulations and lawful expenditure is delivered. Reports provide a section for legal implications, and reports cannot go before Cabinet or Council without this being addressed.

3.2 The Council's Statutory Officers have a positive responsibility to report to the Council, in respect of:

- Co-ordination of functions, staff and management matters – the Chief Executive (Head of Paid Service)
- Financial administration, probity and propriety – the Borough Treasurer and Head of Assets (Section 151 Officer)
- Legality and administration – Borough Solicitor (Monitoring Officer).

3.3 Internal Audit's annual plan contains a programme of work that includes reviews of compliance with policies, procedures, laws and regulations. In addition, work is carried out by Scrutiny Committees, External Audit and other inspection agencies.

3.4 The Head of Internal Audit produces an annual audit report which provides assurance on the adequacy of the Council's control environment.

3.5 The Risk Management Strategy aims to embed risk management into the operational management of the Council and risk assessments are used as part of the key decision making process.

4.0 Whether there is any potential litigation or claims that would affect the financial statements.

4.1 As part of the closure of the accounts the Borough Treasurer and Head of Assets (Section 151 Officer) will assess the adequacy of financial reserves and provisions for known and contingent liabilities arising from current or potential future litigation and claims. The nature and impact of such claims are disclosed in the notes to the accounts. Directors and Heads of Service are required to notify the Borough Treasurer and Head of Assets of any significant control issues which may result in litigation or claims against the Council as part of their annual disclosure statement.