

## **The Vale of Glamorgan Council**

### **Audit Committee: 20th September 2016**

#### **Report of the Managing Director**

### **WAO - The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements**

#### **Purpose of the Report**

1. The purpose of this report is to provide the Audit Committee with a copy of the detailed submission of the Council's response to the Wales Audit Office acting as the Council's External Auditor which relates to the requirements as set out in the International Standard for Auditing (UK and Ireland) 240 - The auditor's responsibilities relating to fraud in an audit of financial statements.

#### **Recommendation**

THAT Members consider the content of this report and note the information provided.

#### **Reason for the Recommendation**

To ensure compliance with the requirements of the International Standards on Auditing.

#### **Background**

2. Under the International Standard for Auditing 240 (ISA 240), the primary responsibility for preventing and detecting fraud rests with both management and "those charged with governance" which for the Vale is the County Council. This includes fraud that could impact on the accuracy of the annual accounts.

#### **Relevant Issues and Options**

3. The ISA 240 requires the Council's External Auditors to obtain an understanding of how the Council exercises oversight of management's processes for identifying and responding to the risks of fraud and the internal controls established to mitigate them. Attached at Appendix A is the Council's responses to the specific enquires made by the External Auditor in order for them to obtain evidence of how management and those charged with governance are discharging their responsibilities.

## **Resource Implications (Financial and Employment)**

4. The External Auditor's responsibility to consider fraud in an audit of the financial statements are set out in the International Standard on Auditing (ISA)

## **Sustainability and Climate Change Implications**

5. None directly from this report.

## **Legal Implications (to Include Human Rights Implications)**

6. The ISA 240 requires the external auditor to obtain an understanding of how the Council exercises oversight of management's processes for identifying and responding to the risks of fraud and the internal controls established to mitigate them.

## **Crime and Disorder Implications**

7. None directly from this report.

## **Equal Opportunities Implications (to include Welsh Language issues)**

8. None as a direct consequence of this report.

## **Corporate/Service Objectives**

9. The work of both internal and external audit is intended to assist in the achievement of all corporate and service objectives.

## **Policy Framework and Budget**

10. The proposals in this report are in accordance with the policy framework and budget.

## **Consultation (including Ward Member Consultation)**

11. None at this stage.

## **Relevant Scrutiny Committee**

12. Corporate Performance and Resources

## **Background Papers**

None

## **Contact Officer**

Helen Smith - Operational Manager - Audit

## **Officers Consulted**

Head of Finance / Section 151 Officer

## **Responsible Officer:**

Rob Thomas - Managing Director

## International Standard for Auditing (UK and Ireland) 240 – The auditor’s responsibilities relating to fraud in an audit of financial statements

### Background

Under the ISA, the primary responsibility for preventing and detecting fraud rests with both management and ‘those charged with governance’, which for Vale is the County Council. This includes fraud that could impact on the accuracy of the annual accounts. The ISA requires us, as external auditors, to obtain an understanding of how the Council exercises oversight of management’s processes for identifying and responding to the risks of fraud and the internal controls established to mitigate them.

What is ‘fraud’ in the context of the ISA?

The ISA views fraud as either:

- the intentional misappropriation of the Council’s assets (cash, property, etc); or
- the intentional manipulation or misstatement of the financial statements.

### What are we required to do?

We have to obtain evidence of how management and those charged with governance are discharging their responsibilities if we are to properly discharge our responsibilities under ISA240. We are therefore making requests from both management and the Council as follows:

Enquiries of management		
Question	Response (15-16 position)	Updated position for 2016-17
1) What is management’s assessment of the risk that the financial statements may be materially misstated due to fraud and what are the principle reasons?	Management’s assessment of the risk is that whilst you cannot give absolute assurance that the financial statements are not misstated due to fraud; no specific fraud issues have been identified during the year. The Internal Audit Shared Service provided satisfactory assurance on all the key financial systems. In addition, this is an integral part of the Audit Committee’s function. They have regard to the reports	No specific fraud issues have been identified during the year; this is supported by the Head of Audit’s Annual opinion report providing satisfactory assurance on all the key financial systems. In addition, and as reported in 2015/16; this is an integral part of the Audit Committee’s function. They have

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	<p>laid before them by both Internal and External Audit / Regulators. This informs their review of the financial statements and the level to which there may be a risk of material misstatement.</p>	<p>regard to the reports laid before them by Internal and External Audit / Regulators. This informs their review of the financial statements and the level to which there may be a risk of material misstatement.</p>
<p>2) How can management assure the Council that it has not been inappropriately influenced by external pressures?</p>	<p>The Council's Constitution sets out the legal framework for the Council overall, its Members and its Officers and it contains policies, procedures and protocols which set out the expectations of both Members and Officers. However, the Council recognises that all services are under financial pressure and the potential increased risks are reflected in the Annual Governance Statement and have been factored into the Audit Risk and Planning process. In addition, the recent completion of the Council's Corporate Assessment has identified that the Council has sound financial planning and management arrangements in place.</p>	<p>The Council's Constitution sets out the legal framework for the Council overall, its Members and its Officers and it contains policies, procedures and protocols which set out the expectations of both Members and Officers. The Council is very much aware that all services are under financial pressure and once again this is factored into the Head of Audit's Annual Opinion and the Council's Annual Governance Statement.</p> <p>Early in 2016/17, the Council received its Corporate Assessment report. The corporate assessment is designed to answer on key question; whether as a local authority the Council is capable of delivering the priorities we have set ourselves and improved outcomes for Vale citizens. In this respect the report is glowing.</p>

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		<p>The WAO concluded that: <i>“The Council has a clear vision of what it wishes to achieve and is making positive changes which should ensure it is well place to continue securing improvements”.</i></p> <p>The report is further evidence that, despite increasing pressures on budgets and demands on services, the Council is performing better than ever.</p>
<p>3) Are management aware of any organisational pressure to meet revenue and capital budgets or other financial constraints?</p>	<p>All services area are under financial pressures and this is reflected clearly and concisely in the Medium Term Financial Strategy.</p>	<p>Yes, All service areas continue to be under financial pressures and this once again clearly and concisely reflected in the Medium Term Financial Strategy.</p>
<p>4) What processes are employed to identify and respond to the risks of fraud more generally and specific risks of misstatement in the financial statements?</p>	<p>The Council's Internal Audit Shared Service plays a crucial part in both identification and responding to the risks of Fraud. The IASS has an annual risk based audit plan which includes key financial systems and all auditors are very mindful of the potential presence of fraud in every audit they undertake. All issues are reported and allegations are investigated by Internal Audit and potential weaknesses in the control environment are identified and reported.</p>	<p>The Council's Internal Audit Shared Service plays a crucial part in both identification and responding to the risks of Fraud. The IASS has an annual risk based audit plan which includes key financial systems and all auditors are very mindful of the potential presence of fraud in every audit they undertake. All issues are reported and allegations are investigated by Internal Audit and</p>

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		<p>potential weaknesses in the control environment are identified and reported. Any matters of significance are reported to the Managing Director, the Head of Finance and Corporate Management Teams. Regular fortnightly updates are provided to the Managing Director and the Head of Finance until such time as the control issues have been addressed.</p>
<p>5) How has management communicated expectations of ethical governance and standards of conduct and behaviour to all relevant parties, and when?</p>	<p>The Council has embodied the principles of good governance and ethical behaviour in its policy documents including Codes of Conduct for both Members and Employees; Procurement guidance and contract conditions. Internal Audit, as an example, have a Code of Ethics which all Auditors append their signature to stating that they have read, understood and will abide by the Code.</p>	<p>The Council has embodied the principles of good governance and ethical behaviour in its policy documents including Codes of Conduct for both Members and Employees; Procurement guidance and contract conditions. Internal Audit, as an example, have a Code of Ethics which all Auditors append their signature to stating that they have read, understood and will abide by the Code.</p> <p>In addition, the Internal Audit Shared Service undertakes an annual review of the Council's Governance arrangements and in particular its compliance with the Code of Corporate Governance.</p>
<p>6) What arrangements are in place to report about fraud to those charged with governance?</p>	<p>Any concerns regarding internal controls, fraud or misappropriation are reflected in Audit recommendations and will impact on the level of assurance given to that particular area and the Council as a whole. Regular reports are taken to both</p>	<p>Any concerns regarding internal controls, fraud or misappropriation are reflected in Audit recommendations and will impact on the level of assurance given to that particular area and the Council as a</p>

	<p>Corporate Management Team and the Council's Audit Committee highlighting where assurance levels are limited and the potential effect on the overall system of internal control.</p>	<p>whole. Regular reports are taken to both Corporate Management Team and the Council's Audit Committee highlighting where assurance levels are limited and the potential effect on the overall system of internal control.</p> <p>In addition, the Managing Director and the Head of Finance receive fortnightly updates on progress.</p>
<p><b>Enquiries of the Council</b></p>		
<p>1) How does the Council, in its role as those charged with governance, exercise oversight of management's processes for identifying and responding to the risks of fraud within the Council and the internal control that management has established to mitigate those risks?</p>	<p>This is reflected in the Audit Committee's Terms of Reference and the reports as set out in the Forward Work Programme for the Committee.</p>	<p>This is reflected in the Audit Committee's Terms of Reference and the reports as set out in the Forward Work Programme for the Committee.</p>
<p>2) Has the Council knowledge of any actual, suspected or alleged fraud since 1 April 2014?</p>	<p>All allegations are taken seriously and investigated. Whilst issues are reported, they will be deemed significant where they can be substantiated and reflected in the Council's Annual Governance Statement if appropriate. No significant cases have been identified since 2014. However for 2015/16 control issues surrounding Contract management have been identified and are being addressed, so far todate there has been no indication that fraud is evident within the system.</p>	<p>All allegations are taken seriously and investigated. Whilst issues are reported, they will be deemed significant where they can be substantiated and reflected in the Council's Annual Governance Statement if appropriate. In 2015/16 control issues surrounding Contract management were identified and as a result of significant input from the Managing Director and Corporate</p>

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		Management Team, together with Internal Audit these issues have now been addressed. A comprehensive training programme has been rolled out for Senior Management covering contract and procurement training together with Project Management training. There has been no indication that fraud is evident within the system.
3) Has the Council any suspicion that fraud may be occurring within the organisation?	Please see above. Internal Audit plays a pivot role in fraud prevention.	Please see above. Internal Audit plays a pivot role in fraud prevention.
4) Is the Council satisfied that internal controls, including segregation of duties, exist and work effectively? If 'yes', please provide details. If 'no' what are the risk areas?	Yes. The overall control environment has been deemed satisfactory by the Council's Head of Audit and reflected in the Annual Opinion Report presented to the Audit Committee on 25 <sup>th</sup> April 2016.	Yes. The overall control environment has been deemed satisfactory by the Council's Head of Audit and reflected in the Annual Opinion Report presented to the Audit Committee on 24 <sup>th</sup> April 2017.
5) How do you encourage staff to report their concerns about fraud and what concerns about fraud are staff expected to report?	Staff are encouraged via the Council's Whistleblowing Policy and the Anti-Fraud and Bribery Policy. Staff are encouraged to report any matter where they consider any form of inappropriate, fraud and or error may be occurring.	Staff are encouraged via the Council's Whistleblowing Policy and the Anti-Fraud and Bribery Policy. Staff are encouraged to report any matter where they consider any form of inappropriate, fraud and or error may be occurring.
6) From a fraud and corruption perspective, what are considered by the Council to be high risk posts within the organisation and how are the risks relating to these posts identified, assessed and managed?	The Council operates a zero tolerance policy therefore every Member and Officer irrespective of their position or duties within the organisation are expected to act with total integrity at all times.	The Council operates a zero tolerance policy therefore every Member and Officer irrespective of their position or duties within the organisation are expected to act with total integrity at all

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		times.
7) Is the Council aware of any related party relationships or transactions that could give rise to instances of fraud and how does the Council mitigate the risks associated with fraud related to related party relationships and transactions?	No – not to our knowledge	No – not to our knowledge
8) Is the Council aware of any entries made in the accounting records of the organisation that it believes or suspects are false or intentionally misleading?·	No – not to our knowledge	No – not to our knowledge
9) Is the Council aware of any organisational, or management pressure to meet revenue and capital budgets or other financial constraints?	Yes and these are reflected in the Council's Medium Term Financial Plan.	Yes and these are reflected in the Council's Medium Term Financial Plan.

## International Standard for Auditing (UK and Ireland) 250 – Consideration of laws and regulations in an audit of financial statements Background

Under the ISA, in the UK and Ireland, the primary responsibility for ensuring that the entity's operations are conducted in accordance with laws and regulations and the responsibility for the prevention and detection of non compliance rests with management and 'those charged with governance', which for MCC is the County Council. The ISA requires us, as external auditors, to obtain an understanding of how the Council gains assurance that all relevant laws and regulations have been complied with.

### What are we required to do?

We have to obtain evidence of how management and those charged with governance are discharging their responsibilities, if we are to properly discharge our responsibilities under ISA 250. We are therefore making requests from both management and the Council:

<b>Enquiries of management</b>		
<b>Question</b>	<b>Response</b>	<b>Update at 2016-17</b>
1) How have you gained assurance that all relevant laws and regulations have been complied with?	Through the work of the Council's Internal Audit Shared Service and Legal Services.	Through the work of the Council's Internal Audit Shared Service and Legal Services.
2) Are there any potential litigations or claims that would affect the financial statements?	No – not to our knowledge	No – not to our knowledge
<b>Enquiries of the Council</b>		
1) How does the Council, in its role as those charged with governance, exercise oversight of management's processes to ensure that all relevant laws and regulations have been complied with?	Through the work of the Council's Internal Audit Shared Service. In addition the Council has robust Contract and Financial Procedure Rules in place.	Through the work of the Council's Internal Audit Shared Service. In addition the Council has robust Contract and Financial Procedure Rules in place.
2) Is the Council aware of any non-compliance with relevant laws and regulations?	No – not to our knowledge	No – not to our knowledge
3) If there have been instances of non-	N/A	N/A

<p>compliance what are they, and what oversight has the Council had to ensure that action taken by management to address and gaps in control?</p>		
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## International Standard for Auditing (UK and Ireland) 550 – Related parties

### Background

The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. For example:

- Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
- Information systems may be ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.
- Related party transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration.

Because related parties are not independent of each other, many financial reporting frameworks establish specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and actual or potential effects on the financial statements. An understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether one or more fraud risk factors are present as required by ISA (UK and Ireland) 240, because fraud may be more easily committed through related parties.

### What are we required to do?

Where the applicable financial reporting framework establishes requirements for related parties, the auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions or balances in accordance with the requirements of the framework. We are therefore making requests from both management and the Council:

<b>Enquiries of management</b>		
<b>Question</b>	<b>Response</b>	<b>Update at 2016-17</b>
1) What controls are in place to identify, authorise, approve, account for and disclose related party transactions and relationships?	Regular discussion with Accountants and finance staff to identify related parties and put together the required disclosures.	Regular discussion with Accountants and finance staff to identify related parties and put together the required disclosures.
2) Confirm that you have: <ul style="list-style-type: none"> <li>disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which you are aware; and</li> <li>appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework.</li> </ul>	Yes, related parties have been disclosed and accounted for in the accounts	Yes, related parties have been disclosed and accounted for in the accounts
<b>Enquiries of the Council</b>		
1) How does the Council in its role as those charged with governance, exercise oversight of management's processes to identify, authorise, approve, account for and disclose related party transaction sand relationships?	Related party disclosures are reviewed by Audit Committee.	Related party disclosures are reviewed by Audit Committee.

