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**Reference:** JH12/NG

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Dear Ben

## City & County of Swansea – 2017-18 - audit enquiries to those charged with governance and management

In my 2018 Audit Plan I noted that International Standards on Auditing (UK&I) state that I am responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. I set out the respective responsibilities of auditors, management and those charged with governance. I also advised that I would be writing to both management and those charged with governance to explain these responsibilities further and make enquiries of how the responsibilities have been discharged.

This letter formally seeks documented consideration and understanding on a number of governance areas that impact on my audit of your financial statements. These considerations are relevant to both the management and 'those charged with governance' of the City & County of Swansea (the Council).

I have set out below the areas of governance on which I am seeking views.

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; and
  - 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.

5. Management processes to identify, authorise, approve, account for and disclose related party transactions and relationships.

The information you provide will inform our understanding of the Council and its business processes and support our work in providing an audit opinion on your 2017-18 financial statements.

I would be grateful if you could complete the attached table in [Appendix 1](#), which should be formally considered and communicated to us on behalf of both management and those charged with governance (the Council) by 31 July 2018. In the meantime, if you have queries, please contact Geraint Norman on 07810 056 683 or by e-mail at [geraint.norman@audit.wales](mailto:geraint.norman@audit.wales).



John Herniman  
Engagement Director

cc Mr Phil Roberts, Chief Executive

## Appendix 1

### 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 the City & County of Swansea (the Council) is the ‘full 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 UHB’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:

Enquiries of management	
Question	Response
1. What is management’s assessment of the risk that the financial statements may be materially misstated due to fraud and what are the principal reasons?	Remain Low/Minimal but constantly vigilant to the risk.  Same core staff worked on financial statements this year as last. But with sufficient segregation of duties in each role.  Internal audit reviews in year. Personal review by S151 officer.

2. How can management assure the Council that it has not been inappropriately influenced by external pressures?

Independence of Monitoring Officer and S151 officer.

Both have right of reporting direct to Cabinet/Council.

Both have professional right of reporting to CX (since strengthened in March 2017 management restructure).

Statutory Chief Officers are full members of CMT.

Enquiries of management	
Question	Response
3. Are management aware of any organisational pressure to meet revenue and capital budgets or other financial constraints?	<p>Yes – the entire public sector in Wales is subject to significant constraint in terms of likely future real terms resource availability. The Council has published a three year medium term financial plan looking for savings in the region of £70m.</p> <p>This is considered a statement of projected fact/expectation.</p> <p>There is no pressure to achieve a certain outcome beyond that which would be reasonably expected , that is, appropriate management and Executive action to contain spending to within a balanced budget position.</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>Online reporting tool for staff to report suspected fraud cases directly to the Fraud Team inbox.</p> <p>Dedicated fraud reporting phone number published online (internal and external referrals).</p> <p>Participate in NFI data matching exercises.</p> <p>Management review of all accounting statements.</p> <p>Internal audit function.</p> <p>Review by Audit Committee.</p>

	<p>Consistency/experience of staff working on financial statements both in terms of central consolidation but also individually as professionals so sufficient segregation of duties and professional oversight/check.</p> <p>Personal review by S151 officer.</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>Published and well publicised on the intranet, separate but complementary Staff and Member Codes of Conduct.</p> <p>In addition, Public Sector Internal Audit Standards require audit team to declare adherence to a code of ethics. The team have all signed and returned these.</p>
<p>6. What arrangements are in place to report about fraud to those charged with governance?</p>	<p>Disciplinary/fraud cases highlighted and reported both via PFM process and through to CMT monthly as part of HR dashboard reporting.</p> <p>Established Audit Committee.</p> <p>Annual fraud report goes to Audit Committee plus annual fraud plan.</p> <p>Right of Chief Internal Auditor and/or S151 to report to Audit Committee.</p> <p>Right of Chief Internal Auditor and S151 officer to report directly to CX on any material concern.</p> <p>Material individual concerns communicated by S151 to relevant member of CMT.</p>

## Enquiries of the Council

Question	Response
<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>Provision of a well-resourced Internal Audit section.</p> <p>Experienced Fraud Team (as part of the core Audit Function).</p> <p>Audit Committee.as well as responding to audit reviews is taking an increasingly active role in looking at wider risk management/risk register.</p> <p>Recently appointed new Independent Audit Committee Chair.</p>
<p>2. Has the Council knowledge of any actual, suspected or alleged fraud since 1 April 2017?</p>	<p>No material items - ongoing fraud investigation of a range of cases is "normal business" and shared with internal/external audit as necessary.</p>
<p>3. Has the Council any suspicion that fraud may be occurring within the organisation?</p>	<p>No material cases – again "normal business" is such that there are risks in an organisation of this scale and there is a resourced corporate fraud team under the Chief Internal Auditor to review and report on individual cases.</p>
<p>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?</p>	<p>Yes. Financial Procedure Rules.</p> <p>Oracle Workflow rules requiring separate sign off of transactions above threshold levels.</p> <p>Internal audit specifically review segregation of duties as part of all audits undertaken.</p>

## Enquiries of the Council

Question	Response
<p>5. How do you encourage staff to report their concerns about fraud and what concerns about fraud are staff expected to report?</p>	<p>Published Anti-Fraud and Corruption policy.</p> <p>Published Disciplinary Policy</p> <p>Published Whistleblowing Policy</p> <p>Fraud/Whistleblowing telephone hotline – intranet coverage/news stories/online reporting forms available.</p>
<p>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?</p>	<p>Chief Officer and Head of Service Posts</p> <p>A range of other senior posts</p> <p>Finance posts above Grade 10</p> <p>Full DBS checks on high risk posts</p>
<p>7. Is the Council aware of any related party relationships or transactions that could give rise to instances of fraud and how does the Audit Committee mitigate the risks associated with fraud related to related party relationships and transactions?</p>	<p>No</p>
<p>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?</p>	<p>No</p>
<p>9. Is the Council aware of any organisational, or management pressure to meet revenue and capital budgets or other financial constraints?</p>	<p>Yes</p> <p>There remains significant risk of failure to deliver all planned savings and there was an overspend at outturn at service level of around £5m, albeit this was significantly reduced by one off steps taken by the S151 officer, thus reducing the draw from General</p>



	<p>Reserves to £3m. This position is not sustainable in the longer term. Risks have not been fully ameliorated for 18-19 and this is especially important given the s151 officer, in advising on the budget, declared reserves to already be at the absolute minimum he could deem adequate.</p> <p>All options continue to be explored to assure removing over spending but future formal enforcement action is a real possibility.</p> <p>The entire public sector in Wales is subject to significant constraint in terms of likely future real terms resource availability. The Council has published a three year medium term financial plan looking for savings in the region of £70m.</p> <p>This is considered a statement of projected fact/expectation.</p> <p>There is no pressure to achieve a certain outcome beyond that which would be reasonably expected, that is, appropriate management and Executive action to contain spending to within a balanced budget position.</p>
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**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 the Council (as 'those charged with governance'). 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>
1. How have you gained assurance that all relevant laws and regulations have been complied with?	<p>Constitution specifies officer delegation and proper officer arrangements for procurement, contracting, entering into legal agreements etc. Legal and finance sign off required in each case.</p> <p>All Heads of Service required to complete governance assurance declarations which are reviewed by the Monitoring Officer and others including the S151 Officer and Chief Internal Auditor to assist in forming an overall view as to compliance.</p> <p>A small number of issues have arisen and are flagged in that governance assurance and reporting which indicate some areas of potential non-compliance which will be addressed going forward but are not considered unduly material for the size and complexity of the Council.</p>

<p>2. Are there any potential litigations or claims that would affect the financial statements?</p>	<p>Potentially yes - given the size of the authority there are always outstanding potential litigations and obligations, both general and very specific in nature.</p> <p>Items of material nature are as fully disclosed in the statement of accounts as is possible under contingent liabilities and provisions having due regard to confidentiality, commercial terms and data protection laws.</p>
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**Enquiries of the Council**

<b>Question</b>	<b>Response</b>
<p>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?</p>	<p>All formal reports to Cabinet/Council require legal, access to services and finance sign off</p>
<p>2. Is the Council aware of any non-compliance with relevant laws and regulations?</p>	<p>See section 1 above re management</p>
<p>3. If there have been instances of non-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>	<p>See section 1 above re management</p>

## 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 summarising 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>
1. What controls are in place to identify, authorise, approve, account for and disclose related party transactions and relationships?	As part of our closure processes we test and review transactions with third parties. Where there appear to be related parties these are escalated through management and decision made by the S151 officer as to materiality/relevance for disclosure in the statement of accounts.
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  Yes
<b>Enquiries of the Council</b>	
<b>Question</b>	<b>Response</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 transactions and relationships?	This is delegated to the S151 officer through control processes.  Necessary and appropriate disclosures are made in the statement of accounts which is reviewed by Audit Committee and approved by Council.