



Audit Update Report

Durham County Council

February 2020





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1. AUDIT AND ASSURANCE PROGRESS

Purpose of this report

This report provides the Audit Committee with an update on progress in delivering our responsibilities as your external auditor and also for our work in respect of our housing benefit assurance work.

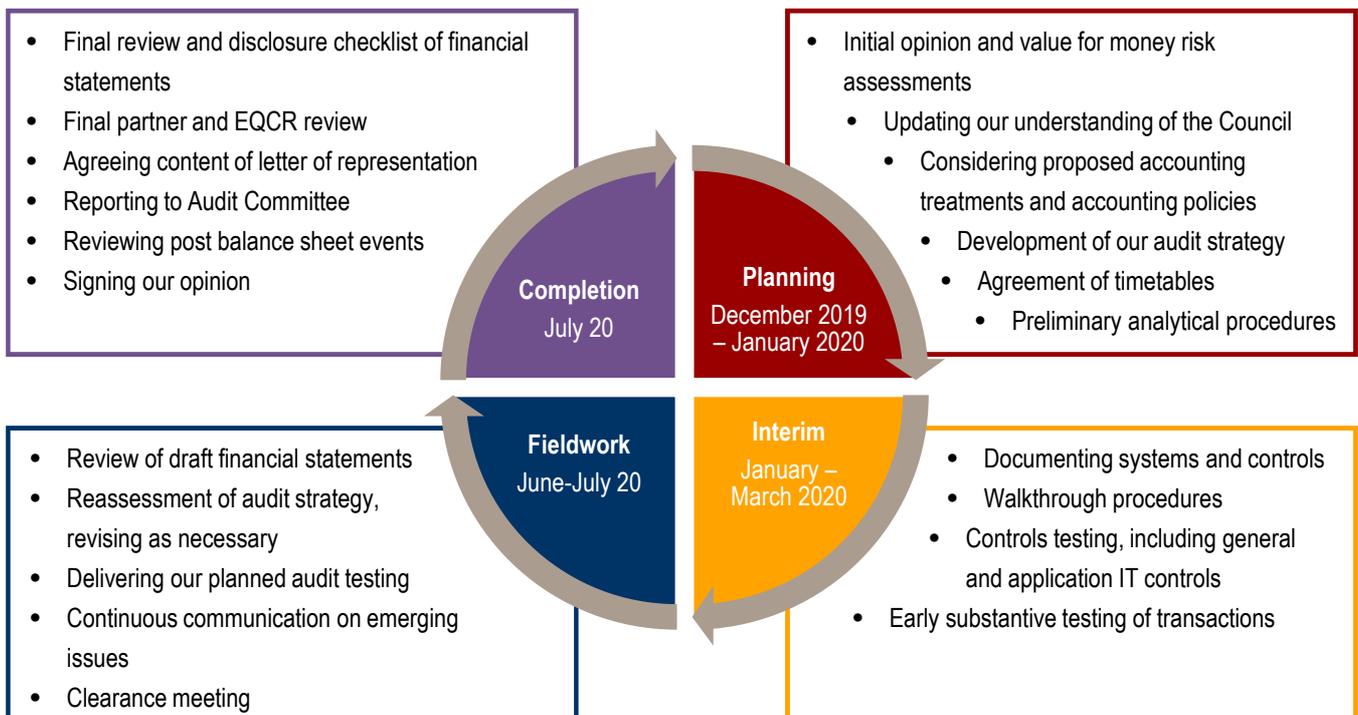
Audit progress

Our key audit stages are summarised in the diagram shown below.

At the time of presenting this report we have completed our audit planning and will present our Audit Strategy Memorandum (ASM) to this Committee. Our ASM will summarise our approach to completing this year's audit, highlighting the significant risks and other areas of focus we will consider.

We are currently completing our interim audit in advance of our year-end fieldwork, which we plan to start in June. This work will reduce the amount of testing to be completed as part of the year-end visit and will focus on transaction testing for income, expenditure, payroll and journals. We also plan to complete some work on property valuations in preparation for the year-end.

There are no significant matters arising from our audit work to report to you at this stage.



1. AUDIT AND ASSURANCE PROGRESS

2018/19 Housing Benefits subsidy assurance

In our November progress report we provided an update on our grants work. In relation to our Housing Benefits assurance work we reported that our work was ongoing and therefore we would provide Members with detailed findings from this work at the next Audit Committee meeting.

This an 'agreed upon procedures' assurance engagement in respect of the Council's annual subsidy claim to the Department of Work and Pensions (DWP) for housing benefits. The requirements of this work are specified in guidance issued by the DWP "Housing Benefits Assurance Process" (HBAP). The Council engaged Mazars as Reporting Accountant for the 2018/19 return. The fee for this work is £16,500 (plus VAT).

The purpose of the engagement is to perform the specific test requirements determined by the DWP on the defined sample basis. The relevant requirements are set out in the Modules of the HBAP reporting framework and we report the results of those procedures to the Council and the DWP. The guidance is made available on the government's website:

<https://www.gov.uk/government/publications/housing-benefit-assurance-process-hbap>

The value of the subsidy claimed in 2018/19 is £151,017,114. This is split between different benefit types:

- Rent rebates - £502,802; and
- Rent Allowance - £148,500,531;

The subsidy claimed also includes £2,018,235 of administration subsidy less £4,454 of prior year uncashed payments.

The work is split into:

- agreement of the subsidy claim to supporting working papers;
- initial testing (specified sample sizes);
- extended testing (described as "40+" or 'CAKE – Cumulative Knowledge and Experience' testing where there are errors arising or anticipated based on the prior year); and
- reporting of results, including extrapolated errors, to DWP who then assess whether there will be any loss of subsidy.

Matters reported

At the time of writing this report the draft assurance report included the following matters.

Initial testing

Initial testing of 20 rent allowance cases identified an error in one case where benefit had been overpaid as a result of the incorrect State Retirement Pension figure being used in the benefit entitlement calculation. The Council completed testing of a further 40 cases (40+) to determine if State Retirement Pension had been correctly included in benefit calculations. This additional testing identified 4 further fails. Of these, 1 failed case had no impact, 2 resulted in an underpayment of benefit, and 1 resulted in an overpayment of benefit. The value of the overpayments was £21.68. We are required to extrapolate this error over the error population (£17,534,133) and consequently reported an extrapolated error of £3,507 (error rate of 0.02%). We are not required to report the impact of errors resulting in underpayment of benefit.

1. AUDIT AND ASSURANCE PROGRESS

CAKE testing

The DWP's HBAP approach instructs where initial testing does not match with cumulative audit knowledge and experience (CAKE) then additional testing must be completed. As in previous years, additional testing was completed by Council officers who tested a further 40 cases and focusing on specific issues which arose in previous years. We then carried out our own re-performance of a sample of these cases. This additional testing identified errors in 2018/19 relating to:

- Incorrect self-employed client information used in the calculation of rent allowance. Errors resulted in both under and over payment of benefit. We reported in our qualification letter the extrapolated impact of errors resulting in overpayments (error rate of population tested 0.004%). We are not required to extrapolate errors which result in the underpayment of benefits.
- Errors in recording claimant's capital in rent allowance calculations. The errors either had no impact on benefit paid or resulted in an overpayment of benefit. We reported in our qualification letter the extrapolated impact of errors resulting in overpayments (error rate of population tested 0.03%). We are not required to extrapolate errors which result in the underpayment of benefits.
- Incorrect housing association rent used in a rent allowance calculation. Testing identified no fails. As there have been no fails identified as part of either initial testing or additional testing, there were no errors to report in 2018/19.
- Incorrect rent frequency used in rent allowance calculation. Testing of 40 cases identified 1 error which resulted in an underpayment of benefit. As there is no eligibility to subsidy for benefit which has not been paid, the one underpayment identified does not affect the subsidy and was not, therefore, classified as an error for subsidy purposes.
- Errors in the earned income used in the benefit entitlement calculation for rent allowance. Testing of 40 cases identified 2 cases, both of which resulted in an underpayment of benefit. As there is no eligibility to subsidy for benefit which has not been paid, the underpayment identified does not affect the subsidy and has not, therefore, been classified as an error for subsidy purposes.
- Errors in self employed income in rent rebate calculation. Officers identified that, in total, 25 cases had self employed income in the benefit calculation. Officers tested all 25 cases and identified 9 case fails. Of the 9 case fails 7 had no impact and 2 resulted in an overpayment of benefit. The total value of the overpaid benefit was £214.88. As 100% of the population has been tested the claim form was amended to correct this error.

Officers have confirmed that where underpayments were identified they have ensured those claims affected were amended and the entitled benefit was awarded to the claimant. A total of 9 claims with a value of £40.11 were identified as being underpaid. Remedial actions have been taken by officers to prevent similar errors occurring in the future.

We would like to express our thanks for the assistance provided by the Council's Housing Benefits team during this work.

2. REQUEST FOR INFORMATION

International Auditing Standards require auditors to enquire about arrangements the entity has put in place. We list a number of questions below and would be grateful if the Committee could provide a response for the next Audit Committee. The response should consider the Council and the Pension Fund.

The auditor's responsibility to consider fraud in an audit of financial statements

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 the Audit Committee and management on the following, or similar, issues:

1) How does the Audit Committee oversee management's processes to identify and respond to the risk of fraud and possible breaches of internal control? In particular how the Committee oversees managements:

- Assessment of the risk that the financial statements may be materially misstated due to fraud or error;
- Processes for identifying and responding to risks of fraud in the organisation. This includes any specific risks of fraud which management have identified or that have been brought to its attention, or classes of transactions, account balances, or disclosure for which a risk of fraud is likely to exist;
- Processes for communicating to employees the views on business practice and ethical behaviour. For example updating, communicating and monitoring against the Council's code of conduct; and
- Processes for communicating to those charged with governance the arrangements for identifying and responding to fraud or error

2) Has the Audit Committee knowledge of any actual, suspected or alleged fraud during the period 1 April 2019– 31 March 2020?

3) Has the Audit Committee identified any specific fraud risks within the organisation? For example does it have any concerns that specific areas within the organisation are at greater risk of fraud?

4) Is the Audit Committee aware of any significant breaches of internal control during 2019/20?

5) Is the Audit Committee satisfied that internal controls, including segregation of duties, exist and work effectively? If 'yes', please provide details of these controls. If not:

- Where are the risk areas?
- What other controls are in place to prevent, deter or detect fraud?

6) Is the Audit Committee aware of any related party relationships or transactions that could give rise to instances of fraud?

7) How does the Audit Committee mitigate the fraud risks associated with related party relationships and transactions?

8) Is the Audit Committee aware of any entries made in the accounting records of the organisation that it believes or suspects are false or intentionally misleading? In particular:

- Are there particular balances where fraud is more likely to occur?
- Is the Audit Committee aware of any assets, liabilities or transactions that it believes were improperly included or omitted from the accounts of the organisation?
- Are there any external fraud risk factors which create a high risk of fraud?

9) Is the Audit Committee aware of any organisational, or management pressure to meet financial or operating targets?

10) Is the Audit Committee aware of any inappropriate organisational or management pressure being applied, or incentives offered, to employees to meet financial or operating targets?

Consideration of laws and regulations in an audit of financial statements

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 ISA250. We are therefore making requests from the Audit Committee, and will be making similar enquiries of management:

- 1) How does the Audit Committee gain assurance that all relevant laws and regulations have been complied with. In particular:
 - Is the Committee aware of the process management has in place for identifying and responding to changes in laws and regulations? Please provide details.
 - What arrangements are in place for the Committee to oversee this process?
 - Is the Committee aware of the arrangements management have in place, for communicating with employees, non-executive directors, partners and stakeholders regarding the relevant laws and regulations that need to be followed?
- 2) Does the Committee have knowledge of actual or suspected instances where appropriate laws and regulations have not been complied with? If it is, what actions are management taking to address non-compliance?

Specific consideration of the potential for, and actual, litigation and claims affecting the financial statements

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 501. We are therefore making requests from the Audit Committee, and will be making similar enquiries of management:

- Is the Audit Committee aware of any actual or potential litigation and claims involving the Council that would impact on the financial statements?

Consideration of the going concern assumption in an audit of financial statements

We are required to consider the appropriateness of management's use of the going concern assumption in the preparation of the financial statements if we are to properly discharge our responsibilities under ISA 570. We are therefore making the following request from the Audit Committee:

- 1) How has the Audit Committee assessed and satisfied itself that it is appropriate to adopt the going concern basis in preparing the financial statements?
- 2) Has the Audit Committee identified any events or conditions since the assessment was undertaken which may cast significant doubt on the organisation's ability to continue as a going concern?

Consideration of 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.

Therefore we are making the following request from the Audit Committee:

- 1) What controls are in place to: identify, authorise, approve, account for and disclose related party transactions and relationships?
- 2) Confirmation that the Audit Committee have:
 - disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which they are aware; and
 - appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework.

3. NATIONAL PUBLICATIONS

	Publication/update	Key points
1.	Local Government Financial Resilience index, CIPFA	Online data tool which measures local authorities against a range of indicators to assess their level of resilience.
2.	Financial Management Code, CIPFA	Guidance for good and sustainable financial management in local authorities.
3.	Prudential Property Investment, CIPFA	Guidance on prudent investments in commercial properties.
4.	Case study: succeeding in viability negotiations - Harborough District Council, Local Government Association	Including summary of learning for local authorities – affordable housing development.
5.	Investigation into the rescue of Carillion’s PFI hospital contracts , NAO	For information
6.	New Code of Audit Practice	Subject to Parliamentary approval, it will come into force on 1 April 2020, and will apply from audits of local bodies’ 2020-21 financial statements onwards

1. Local Government Financial Resilience index, CIPFA, December 2019

The resilience index is an online data tool which measures local authorities against a range of indicators to assess their level of resilience against financial shocks and to support financial decision making. Upper tier authorities are judged against nine indicators including social care. The social care measure is excluded for those authorities without social care responsibilities.

The indicators measured include:

- levels of reserves;
- change in reserves;
- reserves sustainability;
- interest payable/net revenue expenditure;
- gross external debt;
- fees and charges to service expenditure ratio;
- council tax requirement/net expenditure ratio; and
- growth above baseline.

The tool allows for year on year comparisons of each authority’s performance, as well as comparisons with similar and neighbouring authorities. Trend analysis is also available for some of the indicators outlined above.

<https://www.cipfa.org/about-cipfa/press-office/latest-press-releases/cipfa-launches-local-government-financial-resilience-index>

3. NATIONAL PUBLICATIONS

2. Financial Management Code, CIPFA, October 2019

Strong financial management is an essential part of ensuring public sector finances are sustainable. The Financial Management Code (FM Code) provides guidance for good and sustainable financial management in local authorities and aims to provide assurance that they are managing resources effectively.

It requires authorities to demonstrate that the processes they have in place satisfy the principles of good financial management. The FM Code identifies risks to financial sustainability and introduces a framework of assurance. This framework is built on existing successful practices and sets explicit standards of financial management. Complying with the standards set out in the FM Code is the collective responsibility of elected members, the chief finance officer and their professional colleagues in the leadership team. Complying with the FM Code with help strengthen the framework that surrounds financial decision making.

The FM Code built on elements of other CIPFA codes during its development and its structure and applicability will be familiar to users of publications such as The Prudential Code for Capital Finance, Treasury Management in the Public Sector Code of Practice and Code of Practice on Local Authority Accounting in the United Kingdom.

The Code applies to all local authorities, including police, fire and other authorities.

By following the essential aspects of the FM Code, local authorities are providing evidence to show they are meeting important legislative requirements in their jurisdictions.

The first full year of compliance will be 2021/22. This reflects the recognition that organisations will need time to reflect on the contents of the Code and can use 2020/21 to demonstrate how they are working towards compliance.

<https://www.cipfa.org/policy-and-guidance/publications/ff/financial-management-code>

3. Prudential Property Investment, CIPFA, November 2019

Increasingly there has been a move towards investments in commercial properties, funded by borrowing, with the key driver of this activity appearing to be the generation of revenue. This publication provides guidance on making the assessments needed to ensure that such acquisitions are prudent and on the risks local authorities must manage when acquiring property.

Statutory investment guidance from the Ministry of Housing, Communities and Local Government (MHCLG) last year set out clearly that local authorities need to consider the long-term sustainability risk implicit in becoming too dependent on commercial income, or in taking out too much debt relative to net service expenditure.

The increased scale of investment in property was recognised by revisions to CIPFA's Prudential Code for Capital Finance and the Treasury Management Code in 2017, but the growing amounts being borrowed for such a purpose are putting a strain on the creditability of the Prudential Framework and reinforce the need to ensure that such acquisitions are affordable, prudent and sustainable.

In addition to the core issue of borrowing in advance of need, which the Prudential Code has very clear provisions on, this publication provides guidance on the risk perspective to the practical assessment of prudence and affordability. Those risks could be very difficult to manage. Even when these issues are managed and there is reliance on investment income, a potential failure or a downturn of the property market may have a direct impact upon local services.

This publication considers such issues and the actions local authorities would need to take to mitigate against such risks.

<https://www.cipfa.org/policy-and-guidance/publications/p/prudential-property-investment>

3. NATIONAL PUBLICATIONS

4. Case study: succeeding in viability negotiations - Harborough District Council, Local Government Association, December 2019

Harborough is a rural district often ranked as one of the best places to live in England. It is noted as a great place to live and work with most people enjoying a high quality of life. House and land prices are, however, the highest in Leicestershire and many residents struggle to get on the housing ladder or even access a suitable and affordable rented property.

Between 2011 and 2018 the District Council identified a policy need for 30-40 per cent of all new housing to be affordable. Between 2011 and 2018 consents have been given for almost 6,000 dwellings but due to viability issues permission has only been secured for 1,000 affordable units of which 500 have been built. This equates to just 16 per cent against a target of 30-40 per cent.

The District Council participated in the Housing Advisors Programme to support the way it approached viability negotiations – exploring the potential to bring this in-house as part of a new commercial assets team and also building on changes to the National Planning Policy Framework around 'viability'. The aim was to build the capacity in-house to undertake appraisal work on developer submissions of viability to appraise them and provide recommendations to allow for planning determinations.

Learning for local authorities

The challenges for local authorities in delivering affordable housing require an understanding of development viability to ensure that local housing strategies are successfully implemented. Developers continue to test adopted policy requirements through the planning process and local authorities require the skills and knowledge to support their position. The lessons from this project are that staff need to be equipped with the necessary skills to procure expert viability support and most importantly to actively manage the resultant contracts.

<https://www.local.gov.uk/topics/housing-and-planning/lga-housing-advisers-programme/housing-advisers-programme-case-15>

5. Investigation into the rescue of Carillion's PFI hospital contracts , NAO, January 2020

The report considers what happened to Carillion's two major public sector construction contracts after it collapsed and how the Private Finance Initiative (PFI) operates in these circumstances. At the time of its collapse Carillion was the main construction contractor for two new hospitals, both being built under PFI:

- the Midland Metropolitan Hospital in Sandwell, West Midlands, to be used by the Sandwell and West Birmingham Hospitals NHS Trust; and
- the Royal Liverpool University Hospital, to be used by the Liverpool University Hospitals NHS Foundation Trust, which was formed on 1 October 2019 through a merger between the Royal Liverpool and Broadgreen University Hospitals NHS Trust and another NHS trust.

The investigation focuses on the role of central government and the trusts in relation to the two hospital projects before, during and after Carillion's failure in January 2018. It sets out:

- the construction problems on each project (Part One);
- how the government and the trusts dealt with the effects of the collapse of Carillion (Part Two); and
- the impact on the schedules and costs of the two projects (Part Three).

<https://www.nao.org.uk/report/investigation-into-the-rescue-of-carillions-pfi-hospital-contracts/>

3. NATIONAL PUBLICATIONS

6. New Code of Audit Practice, NAO, January 2020

The Local Audit and Accountability Act 2014 makes the Comptroller and Auditor General responsible for the preparation, publication and maintenance of the Code of Audit Practice. The Code sets out what local auditors are required to do to fulfil their statutory responsibilities under the Act.

Schedule 6 of the Act requires that the Code be reviewed, and revisions considered at least every five years. The current Code came into force on 1 April 2015, and the maximum five-year lifespan of the Code means it now needs to be reviewed and a new Code laid in Parliament in time for it to come in to force no later than 1 April 2020.

Following the public consultation exercises that took place during 2019, the Comptroller and Auditor General (C&AG) has now approved the text for the final draft of the Code of Audit Practice, which has now been laid in Parliament.

Subject to Parliamentary approval, it will come into force on 1 April 2020, and will apply from audits of local bodies' 2020-21 financial statements onwards.

<https://www.nao.org.uk/code-audit-practice/code-of-audit-practice-consultation/>

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