Audit Committee update

Durham County Council

Audit 2011/12

The Audit Commission is a public corporation set up in 1983 to protect the public purse.

The Commission appoints auditors to councils, NHS bodies (excluding NHS Foundation trusts), police authorities and other local public services in England, and oversees their work. The auditors we appoint are either Audit Commission employees (our in-house Audit Practice) or one of the private audit firms. Our Audit Practice also audits NHS foundation trusts under separate arrangements.

We also help public bodies manage the financial challenges they face by providing authoritative, unbiased, evidence-based analysis and advice.

Contents

Introduction

1 The purpose of this paper is to provide the Audit Committee with a report on progress in delivering our responsibilities as your external auditors. It includes an update on the externalisation of the Audit Practice.

2 This paper also seeks to highlight key emerging national issues and developments which may be of interest to members of the Audit Committee. The paper concludes by asking a number of questions which the Committee may wish to consider in order to assess whether it has received sufficient assurance on emerging issues.

3 If you require any additional information regarding the issues included within this briefing, please feel free to contact me or your Audit Manager using the contact details at the end of this update.

4 Finally, please also remember to visit our website (www.audit-commission.gov.uk) which now enables you to sign-up to be notified of any new content that is relevant to your type of organisation.

Cameron Waddell

District Auditor

6 February 2012

Progress report

Financial statements

5 We agreed the Audit Fee with the Chief Executive in April 2011. There have been several changes to the audit requirements and environment within which the Audit Commission and the Council operate and the continued downturn in the economic climate continues to impact on the work we are required to undertake.

6 As in previous years, part of the risk assessments involves asking those charged with governance and management about arrangements in place for:

- preventing and detecting fraud;
- ensuring the legality of transactions and identifying potential litigation;
- adopting the going concern principal for the accounts; and
- related party relationships and transactions.

7 The letters to the Corporate Director Resources and the briefing note to the Audit Committee are attached in appendices 1 and 2 of this document.

8 We are carrying out our walkthrough testing of the Council's significant financial systems (including those relating to the Pension Fund) and hope to have completed most of these by the end of March 2012. We will test the key controls within these systems where appropriate and will evaluate the Council's overall control environment. This understanding enables us to focus our audit on relevant matters. It also enables us to highlight to you any significant weaknesses in how these systems produce materially accurate figures for the financial statements.

9 We will also carry out early substantive testing on material balances and transaction that you expect to include in the financial statements. This reduces pressure on officers at the post-statements stage of the audit in July.

10 Key finance staff will be attending our final accounts workshops in February 2012 which provide a unique opportunity to focus on the changes for future financial statements, well in advance of the accounts submission date.

11 We will continue to liaise with the Corporate Director Resources, Principal Finance Officer (Strategic Finance) and Manager of Internal Audit and Risk to discuss audit issues and ongoing developments at the Council.

VFM conclusion

12 The Commission introduced a new approach to auditors' local value for money work (VFM) from 2010/11. In particular, this approach is intended to recognise the increased pressure on public spending and the scale of funding cuts to address the state of the UK's public finances.

Our initial risk assessment has identified the following VFM risks.

- Financial Resilience.
- Securing economy, efficiency and effectiveness.

13 Work will focus on updating our understanding on an ongoing basis until the point at which the VFM conclusion is issued, and will largely comprise:

- outcomes from our review of agendas, minutes and other reports; and
- outcomes from our programme of established liaison meetings with officers.

14 Our view continues to be that Durham County Council has sound arrangements to address financial resilience and arrangements to secure economy, efficiency and effectiveness. Our audit work will challenge whether this continues to be the case.

Other matters of interest

Government response to consultation on the future of local public audit

15 In August 2010, the government announced its intention to bring forward legislation to abolish the Audit Commission and put in place a new framework for local public audit. In March 2011, the government published a consultation paper and, in January 2012, announced its response to the consultation to which it received 453 responses, the majority from audited bodies.

16 The Audit Commission is currently in the process of the award of contracts for the work currently undertaken by the Audit Practice for the period 2012/13 to either 2014/15 or 2016/17 (see ‘update on the externalisation of the Audit Practice’ below). The government envisages the retention of the Audit Commission as a small residuary body until the end of those contracts, to oversee them and to make any necessary changes to individual audit appointments.

17 Thereafter, the government proposes that a new local public audit regime will apply. The key features of that regime are as follows.

- The National Audit Office will be responsible for developing and maintaining audit codes of practice and providing support to auditors.
- Mirroring the Companies Act provisions, auditors will be subject to the overall regulation of the Financial Reporting Council (the FRC). The FRC will authorise one or more Recognised Supervisory Bodies (in practice, the professional institutes) to register and supervise audit firms and engagement leads.
- Directly-elected local government bodies will appoint their own auditor on the advice of an independent audit appointment panel with a majority of independent members. Such panels may be shared between audited bodies
- Audited bodies must run a procurement exercise for their external audit appointment at least every five years, although there would be no bar on the reappointment of the incumbent audit firm (for a maximum of one further five-year term);
- Audited bodies will be able to remove their auditor, but only after due process, involving the independent audit appointment panel and culminating in a public statement of the reasons for the decision.
- The audit will continue to cover arrangements for securing economy, efficiency and effectiveness, but without imposing further burdens on audited bodies. There will be further consultation on the approach to value for money.
- The power to issue a public interest report will be retained.

- Audit firms will be able to provide non-audit services to audited bodies, subject to complying with ethical standards and gaining approval from the independent auditor appointment panel.
- The right to object would be retained, but the auditor will be given the power to reject vexatious, repeated or frivolous objections.
- Grant certification will be subject to separate arrangements between grant paying bodies, audited bodies and reporting accountants (who could be the external auditors).
- The National Fraud Initiative will continue. Discussions on how this will be achieved are ongoing.

18 The government is holding further discussions with audited bodies and audit firms to develop its proposals. The Regional Improvement and Efficiency Partnerships are organising events in January and February 2012 to which audited bodies have been invited. The government intends to publish draft legislation for pre-legislative scrutiny in Spring 2012.

Update on the externalisation of the Audit Practice

19 The Audit Commission's Chief Executive, Eugene Sullivan, wrote to clients on 21 September 2011 summarising the Department for Communities and Local Government's plans for externalising the Audit Commission's work that is currently undertaken by the Audit Practice. An update on progress was provided in Eugene's subsequent letter of 10 November 2011.

20 The key points are as follows.

- Contracts will be let from 2012/13 on a three- or five-year basis. The earliest you will be able to appoint your own auditors is therefore for the 2015/16 audit.
- The work is split into four regions, comprising ten 'lots'. Each lot will be awarded separately, but any individual bidder can only win a maximum of one lot in each region (ie four lots in total).
- The Commission is managing a fair and equitable procurement process to allow suitable private sector providers the opportunity to compete for the contracts.
- Thirteen potential providers were invited to tender following the initial pre-qualification stage. The deadline for return of the tenders was 16 December 2011. Tenders received are currently being evaluated. The Commission plans to announce the successful tenderers in March 2012.
- The Commission is planning to set out, early in 2012, the consultation process to be followed for individual audit appointments. For bodies currently audited by the Audit Practice, there will be an opportunity to attend an introductory event in each contract area with the Commission and the firm awarded the contract. The events will take place in May 2012.

- Appointments will start on 1 September 2012. As such, the Commission is extending the current audit appointment to allow any audit issues arising between 1 April 2012 and 31 August 2012 to be dealt with. The Commission's Director of Audit Policy and Regulation wrote to clients on 19 December 2011 setting out more details on this 'interim' appointment.
- Audit Practice staff in each lot area will in the main transfer to the successful bidders on 31 October 2012.

21 Further details are available on the Commission's website. We will continue to keep you updated on developments.

22 Against this background, the Audit Practice's focus remains.
- Fulfilling our remaining responsibilities – completing our work for 2010/11 and delivering your 2011/12 audit - to the high standards you expect and deserve.
- Managing a smooth transition from the Audit Practice to your new audit provider.

2010/11 Accounts

23 In December 2011 the Audit Commission published a report - Auditing the Accounts 2010/11 - which summarises its findings of the accounts audits in 2010/11.

24 The report covers the quality and timeliness of financial reporting by councils, police authorities, fire and rescue authorities and other local public bodies. In addition to auditors' work on the 2010/11 financial statements, the report also covers:
- the results of the first year of International Financial Reporting Standards (IFRS) implementation;
- auditors' work on the Whole of Government Accounts returns;
- auditors' local value for money work;
- public interest reports and statutory recommendations issued by auditors since December 2010; and
- the key challenges facing bodies for 2011/12.

25 Auditors were able to give opinions on the accounts by the target date of 30 September 2011 at most organisations and this performance compares well with the previous year.

26 However, the challenges presented by the transition to IFRS are demonstrated by an increase in the number of bodies, from seven last year to eighteen this year, where the auditor's opinion was still outstanding after 31 October. There was also a significant increase in the number of bodies needing to make material adjustments to their accounts following the audit.

27 On 18 January 2012, the Audit Commission published 'Let's be clear: Making local authority IFRS accounts more accessible and understandable'.

28 This briefing supplements the report on the 2010/11 accounts referred to above and focuses on a long-running debate of how to make local government accounts easier to understand.

29 While the statutory accounts give comprehensive information on each local authority's financial position and performance, reflecting the range of activities which they cover, they are a poor way of communicating the key information to lay readers.

30 The briefing notes that:

- elected members and local people would benefit from having access to well-presented extracts from the accounts, which would provide the key information on each authority's financial position and performance;
- the accounting profession and the Audit Commission could do more to encourage auditors and preparers of accounts to reduce clutter in statutory accounts; and
- each authority could do more to ensure their accounts are shorter and more accessible. Those preparing accounts need to look critically at the previous year's accounts. They should identify how these accounts could be sharper and more focused before starting work on the next set.

31 The briefing concludes by identifying possible steps to make local authority accounts more accessible and easier to understand, and the implications of doing so.

32 The Audit Commission is seeking views on the issues raised within the briefing and has invited comments by 16 March 2012 - further information on this is available on the Audit Commission's website.

Managing Workforce Costs

33 The Audit Commission and Local Government Association have jointly launched 'Work in progress: Meeting local needs with lower workforce costs'.

34 The joint report - which can be found on the Audit Commission's website - is aimed at councils as employers and shows how local authorities across England are reducing their workforce costs, with some finding creative solutions.

35 As government funding for councils shrinks by over a quarter between 2011/12 and 2014/15, councils need to reduce their workforce costs substantially while still providing much needed services. Not all councils face the same financial challenges, but the message is that all must reassess what they do, how they do it, and what their priorities are. Those opting for major restructuring will take more time to realise savings.

36 Councils are finding ways to cut their pay bills without losing jobs, but the report says that redundancies are inevitable. Local government was already reducing posts before the cuts in government funding. In the past year an estimated 145,000 jobs have gone and this figure will increase in the future. So far many redundancies have been voluntary, but the report warns that compulsory ones are set to rise.

37 The report is supported by a number of resources including:

- an agency workers expenditure tool which shows councils how much they spend on agency workers, compared with groups of similar councils;
- a workforce expenditure tool which shows councils how much they spend on staff as a proportion of their net current expenditure, and how this has changed over time;
- five case studies which provide examples of the different approaches councils are taking to reduce the costs of employing people while protecting valuable services. The case studies show what the councils did and why - and the benefits achieved; and
- a practical guide on how to undertake effective pay benchmarking, providing a series of steps to follow when starting a pay benchmarking process and highlighting the main issues that should be considered.

38 The report is supplemented with a briefing for elected members that includes a number of questions designed to help members assess how well their council decides the size, shape and cost of its workforce and how these decisions will affect services and communities.

39 The questions are in two parts.

- The information that should be available to members about the workforce.
- The savings strategies councils could follow in the light of that information.

Joining up health and social care

40 On 1 December 2011 the Audit Commission published the second in a series of briefings looking at adult social care.

41 'Joining Up Health and Social Care - Improving Value for Money Across the Interface' shows significant variations in indicators such as the levels of emergency admissions to hospital. This raises questions about how well services are being integrated to meet the preferences of older people. Despite the focus for many years on improving joint working across the NHS and social care, progress remains patchy.

42 At a time when the whole of the public sector must find significant savings, the report says that integrated working offers opportunities for efficiencies and improvements to services. Without it, there is a risk of duplication and ‘cost-shunting’ - where savings made by one organisation or sector simply create costs for others.

43 The briefing offers guidance to local partnerships, setting out a list of questions to consider and suggestions for interventions that might help. The briefing also includes a number of case studies which show how some areas have embraced partnership working and used local data and benchmarking to establish how and where to make improvements.

44 The Audit Commission has developed a tool to accompany the briefing that allows NHS and social care partnerships to benchmark their performance against others.

CIPFA's Prudential Code for Capital Finance

45 CIPFA has recently updated its Prudential Code for Capital Finance in Local Authorities. This new version reflects the introduction of IFRS which required:

- PFI schemes to be included on organisations' balance sheets; and
- the accounting treatment of leases to be reviewed – with many more likely to be considered as finance leases and thus also included on the relevant balance sheets.

46 The code also includes guidance on the treasury management implications of the housing self-financing reforms.

47 Although local authorities determine their own capital programmes, they are required to have regard to CIPFA's Prudential Code (the Code) in order to ensure that these capital investment plans are affordable, prudent and sustainable.

48 To demonstrate that these objectives have been met, the Code sets out the indicators that must be used and the factors that must be taken into account.

49 The Code does not include suggested indicative limits or ratios and these are for the local authority to set itself, subject to some overriding controls.

50 The prudential indicators required by the Code should be considered alongside its Treasury Management performance indicators. These indicators are both are designed to support and record local decision making and are not designed to be comparative performance indicators.

2011/12 Accounts: CIPFA Guidance Notes for Practitioners

51 CIPFA has recently published a set of guidance notes to provide support in preparing the 2011/12 year-end accounts. These offer constructive advice on all aspects of the requirements for 2011/12 and provide detailed guidance on the key changes, including accounting for:

- heritage assets;
- business rate supplements;
- community infrastructure levies;
- related party disclosures;
- exit packages;
- trust funds;
- financial instruments; and
- interests in joint ventures.

52 The key changes to your financial statements in 2011/12 will also be covered by our final accounts workshops.

For information: Board Governance Essentials

53 The Public Chairs' Forum and CIPFA have recently published a joint 'how to' guide for Chairs and Boards of public bodies.

54 'Board Governance Essentials: A Guide for Chairs and Boards of Public Bodies' offers advice across four key areas.

- Good corporate governance.
- Roles, responsibilities and relationships.
- Standards of behaviour in public life.
- Effective financial management and transparency.

55 This guide may provide interesting reading for all members.

Local Government Finance Bill

56 In December 2011 the government introduced proposals to devolve greater financial powers and freedoms to councils. The Local Government Finance Bill sets out the legislative foundations to implement the changes from April 2013. The most significant proposals relate to non-domestic rates, which are currently pooled and redistributed nationally.

57 The Bill provides for councils to:

- retain a portion of their business rate growth;
- borrow against future income from business rates to pay for roads and transport projects alongside other local priorities;
- ensure a stable starting point for all authorities. No authority will be worse off as a result of their business rates base at the start of the scheme;
- establish a national baseline alongside a system of top ups and tariffs. Councils with business rates in excess of a set baseline would pay a tariff to government whilst those below would get an individually assessed top up from government; and
- create a levy to take back a share of growth from those councils that gain disproportionately from the changes. This money would be used to fund a safety net providing financial help to those authorities which experience significant drops in business rates, for example caused by the closure or relocation of a major business.

58 The Bill provides for much of the detail of the arrangements, including the sharing of business rate growth between billing and precepting authorities, to be left to secondary legislation.

Guide to HRA Self Financing

59 The introduction of self-financing to the housing revenue account (HRA) in April 2012 will fundamentally change the way that local authority housing is funded.

60 CIPFA has therefore recently produced a publication which brings together the latest guidance to assist those working in the sector to understand the changes and help with their implementation.

Code of Practice on Public Sector Pensions

61 In October 2011 CIPFA published a Code of Practice on Public Sector Pensions Finance Knowledge and Skills.

62 Pension schemes are growing in complexity and their financial management in the public sector demands appropriate skills, including a knowledge of:

- financial markets and products;
- financial services procurement;
- pensions accounting and auditing;
- actuarial practices;
- investment performance and risk management; and
- the implications of legal and regulatory requirements.

63 It is CIPFA's view that every public sector organisation should secure appropriate training, having assessed the professional competence of both those involved in pension scheme financial management and those with a policy, management and/or oversight role.

64 Its view is that public sector organisations should also ensure that those charged with pension scheme governance, including audit committees and relevant scrutiny groups, have access to the skills and knowledge they require to carry out this role effectively.

65 CIPFA's Code of Practice has been produced to put these requirements into a formal structure for public sector pension schemes.

Financial Management in Schools

66 On 19 October 2011 the National Audit Office (NAO) published a report covering financial management in local authority maintained schools.

67 Up to 2007/08, schools collectively spent less money each year than they were given, and the sum of unspent primary and secondary school balances peaked at £1.76 billion. As a result, many schools did not need to prioritise efficiency to remain within their budgets.

68 However, more schools are now facing reductions in their budgets in real terms, at the same time as significant changes to qualifications and curricula are being introduced - alongside continuing pressure for improved performance.

69 The NAO found that weak financial management and weak academic performance often go hand in hand. A comparison of Ofsted’s judgements of the overall effectiveness of schools with school surpluses and deficits showed that schools in deficit generally performed worse than schools in surplus.

70 The NAO's report continues a number of recommendations for the Department of Education, but nevertheless should prove of interest to local authorities themselves.

Key considerations

71 The Audit Committee may wish to consider the following questions in respect of the issues highlighted in this briefing paper.

- Has the Council reviewed the Audit Commission's report on the 2010/11 accounts and, in particular, considered the key challenges facing bodies for 2011/12?
- Has the Council reviewed its 2010/11 accounts and identified ways in which these could be streamlined or clarified?
- Has the Council reviewed the Audit Commission / Local Government Association joint report on managing workforce costs and is the Audit Committee satisfied that appropriate use has been made of the supporting materials?
- Has the Council circulated the briefing for elected members on the Audit Commission's workforce report to Members? Is the Audit Committee satisfied that the questions within the briefing have been properly considered by the Council?
- Has the Council reviewed the questions included in the Audit Commission's briefing paper on joining up health and social care?
- Has the Council used the Audit Commission's tool to benchmark the performance of its NHS and social care partnership?
- Has the Council reviewed its prudential indicators in the light of CIPFA's revised prudential code?
- Has the Council reviewed CIPFA's guidance notes for the 2011/12 financial statements and made satisfactory arrangements for their implementation?
- Has the Council reviewed CIPFA's guidance on HRA self-financing and made satisfactory progress for its implementation?
- Has the Council reviewed CIPFA's Code of Practice on Public Sector Pensions and satisfied itself that the arrangements in place are adequate?

Contact details

72 If you would like further information on any items in this briefing, please feel free to contact either your District Auditor or Audit Manager.

73 Alternatively, all Audit Commission reports - and a wealth of other material - can be found on our website: www.audit-commission.gov.uk.

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Appendix 1 Briefing note to those charged with governance

Durham County Council (including the Pension Fund) 2011/12

Audit Committee briefing note - ISA+240 (Fraud), ISA+250 (laws and regulations), ISA+501 (litigation and claims) & ISA+570 (going concern)

Introduction

This briefing note aims to summarise for the Audit Committee the requirements under International Auditing Standards (UK and Ireland), also referred to as ISA+, in respect of preventing fraud in the annual accounts, and compliance with laws and regulations. It sets out the information we will require from the Audit Committee before we give our opinion on the Durham County Council's 2011/12 accounts including the Pension Fund accounts.

International Standard for Auditing (UK and Ireland) 240 - The auditor's responsibility to consider 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 Council is the Audit Committee. 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 Committee 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 ISA+240. We are therefore making requests from the Audit Committee and management on the following, or similar, issues.

How does the Audit Committee, in its role as those charged with governance, exercise oversight of management's processes in relation to:

- undertaking an assessment of the risk that the financial statements may be materially misstated due to fraud or error (including the nature, extent and frequency of these assessments);
- identifying and responding to risks of fraud in the organisation, including 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;
- communicating to employees of views on business practice and ethical behaviour (for example by updating, communicating and monitoring against the organisation’s code of conduct); and
- communicating to those charged with governance the processes for identifying and responding to fraud or error

How does the Audit Committee oversee management processes to identify and respond to the risk of fraud and possible breaches of internal control?

- Is the Audit Committee aware of any breaches of internal control during 2011/12?

Has the Audit Committee knowledge of any actual, suspected or alleged fraud during the period 1 April 2011 – 31 March 2012?

Has the Audit Committee any suspicion that fraud may be occurring within the organisation?

- Has the Audit Committee identified any specific fraud risks within the organisation?
- Does the Audit Committee have any concerns that there are areas within the organisation that are at risk of fraud?
- Are there particular locations within the organisation where fraud is more likely to occur?

Is the Audit Committee satisfied that internal controls, including segregation of duties, exist and work effectively?

- If not, where are the risk areas?
- What other controls are in place to help prevent, deter or detect fraud?

Is the Audit Committee satisfied that staff are encouraged to report their concerns about fraud, and the types of concerns they are expected to report?

From a fraud and corruption perspective, what are considered by the Audit Committee to be high risk posts within the organisation?

- How are the risks relating to these posts identified, assessed and managed?

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

- How are the risks associated with fraud related to such relationships and transactions mitigated?

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?

- 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?
- Could a false accounting entry escape detection? If so, how?
- Are there any external fraud risk factors which are high risk of fraud?

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

- Is the Audit Committee aware of any inappropriate organisational or management pressure being applied, or incentives offered, to you or colleagues to meet financial or operating targets?

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 the Council is the Audit Committee.

The ISA requires us, as external auditors, to obtain an understanding of how the Committee 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 the Audit Committee, and will be making similar enquiries of management.

How does the Audit Committee gain assurance that all relevant laws and regulations have been complied with. For example:

- Is the Committee aware of the process management has in place for identifying and responding to changes in laws and regulations?
- 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?

- Does the Committee have knowledge of actual or suspected instances where appropriate laws and regulations have not been complied with, and if so is it aware of what actions management is taking to address it?

International Standard for Auditing (UK and Ireland) 501 – Specific consideration of the potential for, and actual, litigation and claims affecting the financial statements

Background

This ISA deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence, in this instance with respect to the completeness of litigation and claims involving the entity.

The ISA requires us, as external auditors, to design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement.

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+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 of claims that would affect the financial statements?

International Standard for Auditing (UK and Ireland) 570 – Consideration of the going concern assumption in an audit of financial statements

Background

Financial statements are generally prepared on the basis of the going concern assumption. Under the going concern assumption, an audited body is ordinarily viewed as continuing in operation for the foreseeable future. Accordingly, assets and liabilities are recorded in financial statements on the basis that the audited body will be able to realise its assets and discharge its liabilities in the normal course of its operations.

What are we required to do?

If used, 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:

- How has the Audit Committee assessed and satisfied itself that it is appropriate to adopt the going concern basis in preparing the financial statements?

- 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?

The way forward

The information you provide will inform our understanding of the Council and its business processes, and to enable an opinion to be given on your 2011/12 financial statements.

I would be grateful for your responses, which should be formally considered and communicated to us on the Committee's behalf, by 30 April 2012. In the meantime, if you have any queries, please do not hesitate to contact me.

Catherine Banks,
Audit Manager

February 2012

Appendix 2 Letter to management

Our reference DU08812A

13 February 2012

Don McLure
Corporate Director Resources
Durham County Council
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Dear Mr McLure

Audit of Durham County Council's Financial Statements 2011/12 including the Pension Fund Accounts - Compliance with International Auditing Standards

In order to comply with a number of International Standards on Auditing (ISA (UK&I) 240, 250, 501 and 550) we are required to obtain an understanding of the management processes with regard to fraud and internal control, laws and regulations and potential for litigation and claims affecting the financial statements. This covers the opinion on the Council's 2011/12 accounts including the pension fund accounts.

ISA+ 240 focuses on management processes in place in relation to fraud:

1) We seek an understanding of management's assessment of the risk that the financial statements may be misstated due to fraud, including:

a) How does management undertake its assessment of the risk that the financial statements may be materially misstated due to fraud or error (including the nature, extent and frequency of these assessments)?

b) What is management's process for identifying and responding to risks of fraud in the Council, including 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?

c) What arrangements does management have in place to communicate to employees regarding its views on business practices and ethical behaviour (for example by updating, communicating and monitoring against the Council's code of conduct)?

d) How does management communicate the processes for identifying and responding to fraud or error to the Audit Committee (i.e. those charged with governance)?

2) Does management have knowledge of any actual, suspected or alleged fraud, either within the Council as a whole or within your department during the period 1 April 2011 to 31 March 2012? If so, what actions is management taking to address it?

3) Does management have any suspicion that fraud may be occurring within the organisation?

- Have you identified any specific fraud risks within the Council?
- Do you have any concerns that there are areas within your department or the Council that are at risk of fraud?
- Are there particular locations within the Council where fraud is more likely to occur?

4) Is management satisfied that internal controls, including segregation of duties, exist and work effectively?

- If not, where are the risk areas?
- What other controls are in place to help prevent, deter or detect fraud?

5) Is management satisfied that staff are encouraged to report their concerns about fraud, and the types of concerns they are expected to report?

6) Is management aware of the posts which are considered to be high risk from a fraud and corruption perspective, and what action has been taken to manage the risk?

7) Is management aware of any related party relationships or transactions that could give rise to instances of fraud? How do you mitigate the risks associated with fraud related to such relationships and transactions?

8) Is management aware of any entries made in the accounting records of the Council that it believes or suspects are false or intentionally misleading?

- Are there particular balances where fraud is more likely to occur?
- Are you aware of any assets, liabilities or transactions that you believe were improperly included or omitted from the accounts of the Council?
- Could a false accounting entry escape detection? If so, how?
- Are there any external fraud risk factors which are high risk of fraud?

9) Are you aware of any organisational, or management pressure to meet financial or operating targets?

- Are you aware of any inappropriate organisational or management pressure being applied, or incentives offered, to you or colleagues to meet financial or operating targets?

ISA+ 250 requires that auditors understand how management gains assurance that all relevant laws and regulations have been complied with:

10) How does management gain assurance that all relevant laws and regulations have been complied with?

11) Is management aware of any instances where the Council has not complied with any laws or regulations during 2011/12?

ISA+ 501 requires that auditors obtain confirmation from management around the potential for litigation and claims that would affect the financial statements

12) Is management aware of any actual or potential litigation or claims involving the Council which may result in a material misstatement of the financial statements?

ISA+ 550 requires that auditors identify and assess the risks of material misstatement associated with related party relationships and transactions

13) What controls does the Council have in place to identify, authorise, approve, account for and disclose related party transactions and relationships? For any new related parties (i.e. any not already disclosed in your 2010/11 audited financial statements) please provide a list of them, explain the nature of these, and whether you have entered into any transactions with these related parties during the year to 31 March 2012.

A brief response, on behalf of management, before 30 April 2012 to the above issues would be much appreciated. If in the meantime you have any queries, please let me know.

Yours sincerely

Catherine Banks

Audit Manager

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