Audit Strategy Memorandum

Durham County Council – year ended 31 March 2014

April 2014

MAZARS

Mazars LLP
The Rivergreen Centre
Aykley Heads Durham
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Members of the Audit Committee
Durham County Council
County Hall
Durham
DH1 5UE

April 2014

Dear Sirs/Madams

Audit Strategy Memorandum for the year ending 31 March 2014

We are delighted to present our Audit Strategy Memorandum for Durham County Council for the year ending 31 March 2014.

The purpose of this document is to summarise our audit approach, highlight significant audit risks and areas of key judgements and provide you with the details of our audit team. It is a fundamental requirement that an auditor is, and is seen to be, independent of its clients and Appendix A summarises our considerations and conclusions on our independence as auditors.

We value two-way communication with yourselves and we see this document, which has been prepared following our initial planning discussions with officers, as being the basis for a discussion through which we can also understand your expectations.

This document will be presented at the Audit Committee meeting on 20 May 2014. If you would like to discuss any matters in more detail please do not hesitate to contact me on 0191 383 6314.

Yours faithfully

Cameron Waddell

Mazars LLP

Contents

01 Purpose and background

Purpose of this document

This document sets out our audit plan in respect of the audit of the financial statements of Durham County Council for the year ending 31 March 2014, and forms the basis for discussion at the Audit Committee meeting on 20 May 2014.

The plan sets out our proposed audit approach and is prepared to assist you in fulfilling your governance responsibilities. The responsibilities of those charged with governance are defined as to oversee the strategic direction of the entity and obligations related to the accountability of the entity, including overseeing the financial reporting process.

We see a clear and open communication between ourselves and you as important in:

- Reaching a mutual understanding of the scope of the audit and the responsibilities of each of us;
- Sharing information to assist each of us to fulfil our respective responsibilities;
- Providing you with constructive observations arising from the audit process; and
- Ensuring as part of the two-way communication process that we, as external auditors, gain an understanding of your attitude and views in respect of the internal and external operational, financial, compliance and other risks facing Durham County Council which might affect the audit, including the likelihood of those risks materialising and how they are monitored and managed.

Appendix C outlines the form, timing and content of our communication with you during the course of the audit. Appendix D sets out forthcoming accounting and other issues that will be of interest.

Scope of engagement

We are appointed to perform the external audit of Durham County Council for the year to 31 March 2014. The scope of our engagement is laid out in the Audit Commission's Code of Audit Practice for Local Government bodies.

Responsibilities

The Audit Commission's Statement of Responsibilities of Auditors and of Audited Bodies sets out our respective responsibilities as the auditor and the audited body. The Audit Commission has issued a copy of the Statement to you.

The Statement summarises where the different responsibilities of auditors and of the audited body begin and end and we undertake our audit work to meet these responsibilities.

We comply with the statutory requirements governing audit work, in particular the:

- Audit Commission Act 1998; and
- Code of Audit Practice for Local Government bodies.

We, as auditors to the Council, are responsible for forming and expressing an opinion on the financial statements and reaching a conclusion on the arrangements you have put in place to secure economy, efficiency and effectiveness in the use of your resources (the Value for Money conclusion).

We are also required to report on the consistency of your Whole Government Accounts submission with the audited financial statements. Our audit does not relieve management or the Audit Committee, as those charged with governance, of their responsibilities.

The responsibility for safeguarding assets and for the prevention and detection of fraud, error and non-compliance with law or regulations rests with both those charged with governance and management. In accordance with International Standards on Auditing (UK and Ireland) we plan and perform our audit so as to obtain reasonable assurance that the financial statements taken as whole are free from material misstatement, whether caused by fraud or error. However, our audit should not be relied upon to identify all such misstatements.

As part of our audit procedures in relation to fraud, we are required to enquire of those charged with governance as to their knowledge of instances of fraud, the risk of fraud and their views on management controls that mitigate the fraud risks.

02 Audit scope, approach and timeline

Audit scope

Our audit approach is designed to provide you with an audit that complies with all professional requirements.

Our audit of the financial statements will be conducted in accordance with International Standards of Auditing (UK and Ireland) and in accordance with the Code of Audit Practice for Local Government Bodies. Our work is focused on those aspects of your business which we consider to have a higher risk of material misstatement such as those impacted by management judgement and estimation, application of new accounting standards, changes of accounting policy, changes to operations or areas which have been found to contain material errors in the past.

Audit approach

Our audit approach is a risk based approach primarily driven by the risks we consider to result in a higher risk of material misstatement of the financial statements. Once we have completed our risk assessment we develop our audit strategy and design audit procedures in response to this assessment. The work undertaken will include a combination of the following as appropriate:

- Testing of internal controls;
- Substantive analytical procedures; and
- Detailed substantive testing.

If we conclude that appropriately designed controls are in place then we may plan to test and rely upon these controls. If we decide controls are not appropriately designed, or we decide it would be more efficient to do so, we may take a wholly substantive approach to our audit testing.

Our audit will be planned and performed so as to provide reasonable assurance that the financial statements are free of material misstatement and give a true and fair view. Materiality and misstatements are explained in more detail in Appendix B.

The diagram below outlines the procedures we perform at the different stages of the audit.

Planning

- Planning visit
- Risk assessment
- Considering proposed accounting treatments and accounting policies
- Developing audit strategy
- Agreeing timetable and deadlines
- Preliminary analytical review

Interim work and final fieldwork

- **Interim work**
- Document systems and controls
- Perform walkthroughs
- Interim controls testing
- **Final fieldwork**
- Receiving and reviewing draft financial statements
- Reassessment of audit plan and revision if necessary
- Executing the strategy starting with significant risks and high risk areas
- Communicating progress and issues
- Clearance meeting

Completion

- Final review and disclosure checklist of financial statements
- Final Director review
- Agreeing content of letter of representation
- Reporting to the Audit Committee
- Reviewing post balance sheet events
- Signing the auditor’s report, VFM conclusion, WGA assurance statement and certificate
- Issuing the Annual Audit Letter

Group financial statements

Local authorities are required to consider interests in other entities and whether those interests might necessitate the production of group financial statements. The Council has determined that group financial statements are not required. We will revisit your assessment and consider whether the Council's decision not to prepare group accounts remains reasonable for 2013/14.

Reliance on internal audit

Where possible we will seek to utilise the work performed by internal audit to modify the nature, extent and timing of our audit procedures. We will meet with internal audit to discuss the progress and findings of their work prior to the commencement of our controls evaluation procedures.

Where we intend to rely on the work on internal audit, we will evaluate the work performed by your internal audit team and perform our own audit procedures to determine its adequacy for our audit.

Reliance on other auditors

There are material entries in your financial statements where we will seek to place reliance on the work of other auditors.

Items of account	Other auditor	Nature of assurance to obtain from the auditor
Defined benefit liability and associated IAS 19 entries and disclosures relating to the Council's participation in the Durham County Pension Fund.	Mazars LLP is the appointed auditor for the Durham County Pension Fund.	We have agreed a programme of work that aims to provide assurance over the accuracy of source data used by the actuary.

Service organisations

There are material entries in your financial statements where the Council is dependent on an external organisation. We call these entities service organisations. The table below outlines our approach to understanding the services the Council receives from each organisation and the effectiveness of controls in place to reduce the risk of material misstatement in the financial statements.

Nature of services provided and items of account	Name of service organisation	Audit approach to be adopted
Arms Length Management Organisations (ALMOs) responsible for the management of the Council's housing stock	Dale and Valley Homes	Substantive testing of the transactions recorded in the financial statements
	East Durham Homes	

Reliance on experts

We plan to place reliance on the work of the following experts:

Items of account	Management's expert	Our expert
Defined benefit pension liability and associated IAS 19 entries and disclosures.	The Council uses Aon Hewitt Ltd as its expert in respect of the Local Government Pension.	Audit Commission's consulting actuary (PWC).
Property, plant and equipment valuations.	The Council uses an in-house valuer.	Audit Commission's consulting valuer (Gerald Eve).
Disclosure of the fair value of financial instruments.	The Council uses Capita (formerly Sector) to provide estimates of the fair value of some financial instruments.	We do not routinely use our own expert in respect of fair value disclosures.

Timeline

The diagram below sets out the timing of the key phases of our audit work. We will communicate with management throughout the audit process and will ensure significant issues identified are communicated to those charged with governance on a timely basis.

Dec 2013 to March 2014

- Planning meetings with officers (December 2013)
- Walkthroughs of key systems and controls (December 2013 to March 2014)

March to June 2014

- Interim work, including systems work
- Issue Audit Strategy Memorandum (May 2014)
- Report on interim findings, if required (May 2014)
- Early work for the financial statements (March to June 2014)
- Early technical review of the financial statements (June 2014)

July to Sept 2014

- Draft financial statements and working papers provided (late June to early July 2014)
- Audit fieldwork (July to September 2014)
- Clearance meeting and Issue audit completion report (early September 2014)
- Clearance meeting (September 2014)

30 Sept 2014

- Meeting to approve and sign financial statements
- Issue representation letter
- Finalise financial statements review and issue auditor's report
- Issue auditor's report, Value for Money conclusion and WGA assurance
- Certify completion of the audit
- Issue Annual Audit Letter

03 Significant risks and key judgement areas

We have performed our planning procedures, including risk assessment, as detailed in section 2. In addition, we met with management as part of the audit planning process to discuss the risks that, in management's opinion, the Council faces and have considered the impact on our audit risk. The risks that we identify as significant for the purpose of our audit are the risks of material misstatement that in our judgement require special audit consideration.

We set out below the significant audit risks and the areas of management judgement identified as a result of these meetings and planning procedures which we will pay particular attention to during our audit in order to reduce the risk of material misstatement in the financial statements.

Audit risks

Management override of controls

Description of the risk

Auditing standards state that management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on *all* audits.

How we will address this risk

We have updated our understanding and evaluation of internal controls procedures as part of our audit planning, including completion of a fraud risk assessment. As part of this, we will seek written assurances from the Audit Committee and management on their controls and processes for assessing the risk of fraud in the financial statements and arrangements in place to identify, respond to and report fraud.

We will address this risk through performing audit work over:

- journals recorded in the general ledger and other adjustments made in preparation of the financial statements;
- consideration and review of material accounting estimates impacting amounts included in the financial statements;
- consideration and review of any unusual or significant transactions outside the normal course of business; and
- consideration of any other local factors.

Revenue recognition

Description of the risk

International Standards on Auditing include a rebuttable presumption that a risk of fraud in relation the recognition of revenue always exists. We have decided not to rebut this presumption and as such there is a risk that revenue will be recognised in the incorrect accounting period. This does not imply that we suspect actual or intended manipulation but that we continue to approach the audit with due professional scepticism.

How we will address this risk

We will address this risk by performing audit work relating to journals recorded in the general ledger and other adjustments which recognise revenue, made in the preparation of the financial statements.

In addition to these procedures, we will increase the level of substantive testing performed on revenue items included in the ledger for the 2013/14 and 2014/15 financial years to confirm they have been accounted for in the correct accounting period.

Expenditure recognition

Description of the risk

In the public sector the risk of fraudulent expenditure recognition is of equal likelihood as the risk of fraudulent revenue recognition. As such there is a risk that expenditure will be recognised in the incorrect accounting period. This does not imply that we suspect actual or intended manipulation but that we continue to approach the audit with due professional scepticism.

How we will address this risk

We will address this risk by performing audit work relating to:

- accounting estimates impacting on amounts included in the financial statements; and
- journals recorded in the general ledger and other adjustments which recognise expenditure, made in the preparation of the financial statements.
- In addition to these procedures, we will increase the level of substantive testing performed on expenditure items included in the ledger for the 2013/14 and 2014/15 financial years to confirm they have been accounted for in the correct accounting period.

Pensions entries (IAS 19)

Description of the risk

The financial statements contain material entries in a number of primary statements as well as material disclosure notes in relation to the Council's participation in the Local Government Pension Scheme. These entries arise from complex estimates used by the Council's actuary as well as information provided to the actuary from the Council and the administering body for the Local Government Pension Scheme.

How we will address this risk

We will address this risk by considering the Council's arrangements (including the existence of any relevant controls) for making estimates in relation to pension entries within the financial statements. We will also consider the reasonableness of the actuary's' assumptions used in providing the Council with relevant entries in the financial statements through use of our expert commissioned by the Audit Commission.

Key areas of management judgement

Property, Plant and Equipment (including council housing)

Description of the area of judgement

As in previous financial years, the Council will engage its in-house valuer to carry out a valuation of a proportion of the Council's property and land assets. The valuation of property, plant and equipment is a significant estimate that has a material impact on the financial statements.

Our planned audit approach

We plan to carry out a series of procedures in order to gain sufficient assurance that the carrying value of property, plant and equipment is fairly stated and that the valuation programme carried out by the Council complies with the proper accounting practice. These procedures will include:

- an assessment of the valuation results using information provided to us by our valuation expert as commissioned by the Audit Commission;
- substantive testing of individual properties to review the appropriateness of the valuation basis applied by the valuer and the results of that valuation exercise.

04 Value for Money Conclusion

We are required to conclude whether or not there are any matters arising from our value for money work that we need to report.

Our conclusion on your arrangements is based on two criteria, specified by the Audit Commission:

- securing financial resilience – focusing on whether you are managing your financial risks to secure a stable financial position for the foreseeable future; and
- challenging how you secure economy, efficiency and effectiveness – focusing on whether you are prioritising your resources within tighter budgets and the need to improve productivity and efficiency.

Identified risks

We have considered the risks that are relevant to our value for money conclusion and have not identified any significant risks that need to be addressed specifically through additional work.

The focus of our audit will be how you are addressing the increasing pressures and challenges over the next three to five years given the reductions in central government support and restrictions on council tax increases. Securing financial resilience into the medium term is one of the Council's top priorities.

05 Your audit team

Below are your audit team and their contact details.

Engagement lead / Director	• Cameron Waddell • Email: cameron.waddell@mazars.co.uk • Tel: 0191 383 6314
Engagement Senior Manager	• Catherine Banks • Email: catherine.banks@mazars.co.uk • Tel: 0191 383 6410
Team Leader (Assistant Manager)	• James Collins • Email: james.collins@mazars.co.uk • Tel: 0191 383 6331

In addition to the above, an independent partner has been appointed for this engagement.

Independent Partner	• Suresh Patel • Email: suresh.patel@mazars.co.uk • Tel: 020 7063 4609

06 Fees for audit and other services

Our audit fees for the audit of the financial statements and for any assurance or other services are outlined in the tables below.

Area of work	2013/14 Planned Fee (scale fee)	2012/13 Actual Fee
Opinion and Value for Money conclusion	£333,180	£333,180
Grant certification work	£32,900	£53,200
Total fee	**£366,080**	**£386,380**

Non-audit services

At this stage we do not currently plan any non-audit services, and no audit or non-audit services are provided to the Council by Mazars LLP associated entities.

Appendix A – Independence

We are required by the Financial Reporting Council to confirm to you at least annually in writing that we comply with the Auditing Practices Board's Ethical Standards. In addition we communicate any matters or relationship which we believe may have a bearing on our independence or the objectivity of the audit team.

Based on the information provided by you and our own internal procedures to safeguard our independence as auditors, we confirm that in our professional judgement:

- there are no relationships between us and any of our related or subsidiary entities, and
- you and your related entities creating any unacceptable threats to our independence within the regulatory or professional requirements governing us as your auditors.

We have policies and procedures in place which are designed to ensure that we carry out our work with integrity, objectivity and independence. These policies include:

- All partners and staff are required to complete an annual independence declaration;
- All new partners and staff are required to complete an independence confirmation and also complete computer based ethical training;
- Rotation policies covering audit engagement partners and other key members of the audit team who are required to rotate off a client after a set number of years; and
- Use by managers and partners of our client and engagement acceptance system which requires all non-audit services to be approved in advance by the audit engagement lead.

We wish to confirm that in our professional judgement, as at the date of this document, we are independent and comply with UK regulatory and professional requirements. However, if at any time you have concerns or questions about our integrity, objectivity or independence please discuss these with Cameron Waddell, Engagement Lead.

Prior to the provision of any non-audit services the Engagement Lead will undertake appropriate procedures to consider and fully assess the impact that providing the service may have on our auditor independence.

Appendix B - Materiality

Materiality is an expression of the relative significance or importance of a particular matter in the context of financial statements as a whole.

Misstatements in financial statements are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Judgements on materiality are made in light of surrounding circumstances and are affected by the size and nature of a misstatement, or a combination of both. Judgements about materiality are based on consideration of the common financial information needs of users as a group and not on specific individual users.

The assessment of what is material is a matter of professional judgement and is affected by our perception of the financial information needs of the users of the financial statements. In making our assessment we assume that users:

- have a reasonable knowledge of business, economic activities and accounts;
- have a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented and audited to levels of materiality;
- recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgement and the consideration of future events; and
- will make reasonable economic decisions on the basis of the information in the financial statements.

We consider materiality whilst planning and performing our audit.

Whilst planning, we make judgements about the size of misstatements which we consider to be material and which provides a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

The materiality determined at the planning stage does not necessarily establish an amount below which uncorrected misstatements, either individually or in aggregate, will be considered as immaterial.

We revise materiality for the financial statements as our audit progresses should we become aware of information that would have caused us to determine a different amount had we been aware of that information at the planning stage.

We discuss with management any significant misstatements or anomalies that we identify during the course of the audit and we report in our Audit Completion Report all unadjusted misstatements we have identified other than those which are clearly trivial, and obtain written representation that explains why these remain unadjusted.

Appendix C – Key communication points

ISA 260 'Communication with Those Charged with Governance' and ISA 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' require us to communicate a number of points with you.

Relevant points that need to be communicated with you at each stage of the audit are outlined below.

Form, timing and content of our communications

- We will present to the Audit Committee the following reports:
- Our Audit Strategy Memorandum;
- Our Audit Completion Report; and
- Annual Audit Letter.

These documents will be discussed with management prior to being presented to the Audit Committee and their comments will be incorporated as appropriate.

Key communication points at the planning stage as included in this Audit Strategy Memorandum

- Our responsibilities in relation to the audit of the financial statements;
- The planned scope and timing of the audit;
- Significant audit risks and areas of management judgement;
- Our independence;
- Responsibilities for preventing and detecting errors;
- Materiality; and
- Fees for audit and other services.

Key communication points at the completion stage to be included in our Audit Completion Report

- Significant deficiencies in internal control;
- Significant findings from the audit;
- Significant matters discussed with management;
- Our conclusions on the significant audit risks and areas of management judgement;
- Unadjusted misstatements;
- Management representation letter;
- Our proposed draft audit report; and
- Independence.

Appendix D – Forthcoming accounting and other issues

The 2013/14 CIPFA Code of Practice on Local Authority Accounting (the Code) has made several changes, of which you should be aware. Officers from the Authority's finance function attended workshops that provided full details of the changes in the 2013/14 Code as well as a forward look to potential future accounting changes that may be of relevance to the Authority. If you require detailed information on any of these changes or any other emerging issues, please contact any member of the engagement team.

Forthcoming accounting issues, technical developments or sector specific issues	How this may affect your business
Business rates appeals As a result of the introduction of the business rates retention scheme from 1 April 2013, local authorities are now responsible for meeting the costs of successful rating appeals from local businesses.	It is likely that the Council will recognise a provision in its accounts to recognise the cost of funding future successful rating appeals by local businesses.
Employee benefits (IAS19) The Code includes changes as a result of the adoption of the amended IAS 19 Employee Benefits.	The main potential impacts of the changes are: ▪ changes in terminology used for some entries in the Authority's CIES and disclosure notes; ▪ minor changes to the recognition point for termination benefits that may either delay or bring forward the recognition of expenses such as redundancy payments; ▪ significant changes to the format and content of relevant disclosure notes; and ▪ changes to the classification, recognition and measurement of post-employment benefits. Where these changes have a material impact on the accounts, it is likely that the Authority will need to restate its 2012/13 comparative entries in their accounts.
Property, plant and equipment (PPE) valuations The 2013/14 Code aligns its provisions in relation to the periodic revaluation of PPE more closely with the relevant underlying accounting standard IAS 16.	The Council will need to consider whether its current valuation programme for PPE will meet the revised requirements of the Code.