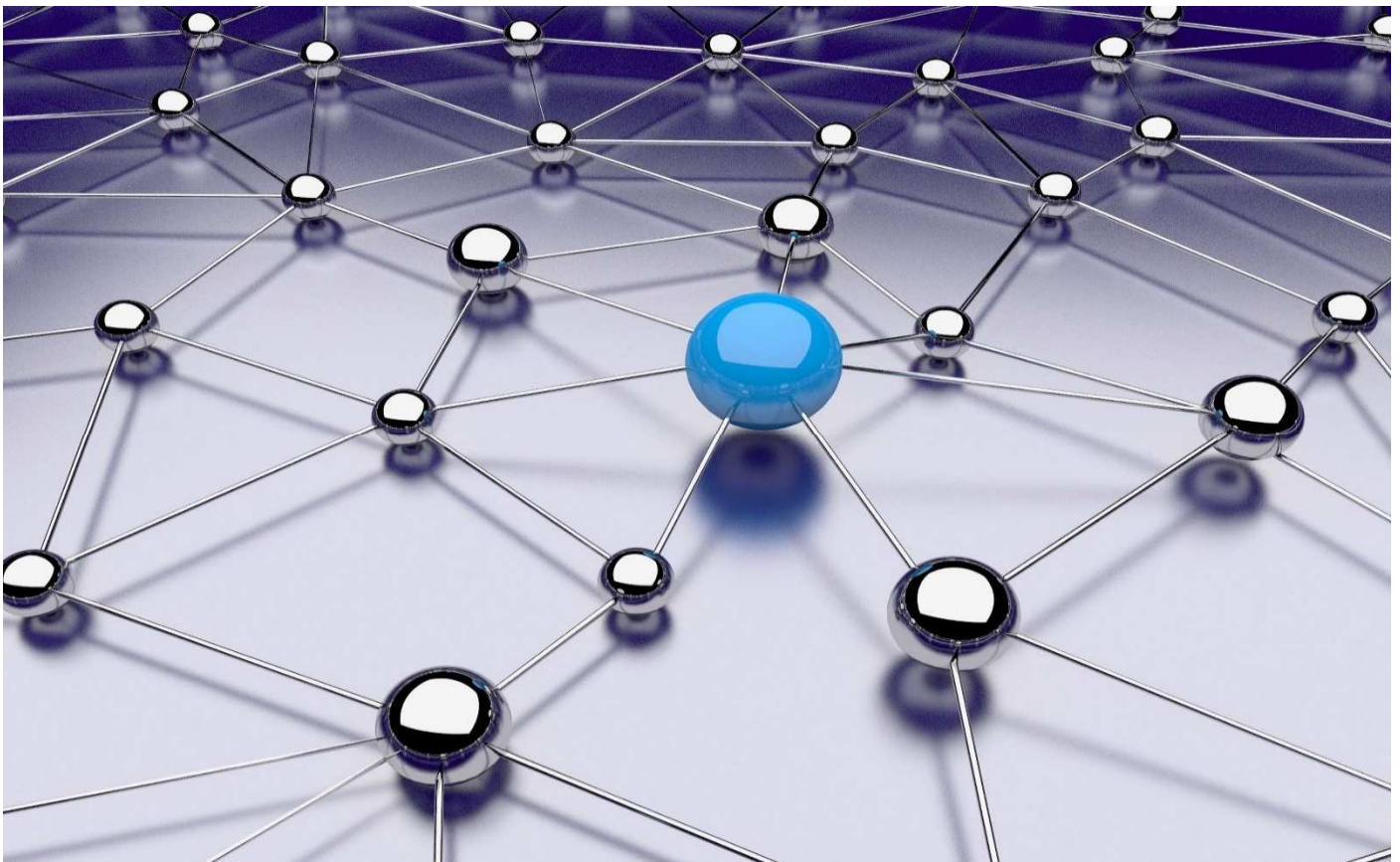


Durham County Council and Durham County Council Pension Fund

Annual Audit Letter

October 2016



Mazars LLP
Rivergreen Centre
Aykley Heads
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October 2016

Audit Committee Members
Durham County Council
County Hall
Durham
DH1 5UE

Dear Audit Committee Members

Annual Audit Letter 2015/16

I am pleased to present our Annual Audit Letter for the 2015/16 audit year. The purpose of this document is to summarise the outcome of the external audit of Durham County Council's 2015/16 financial statements, including Durham County Council Pension Fund, and our review of your arrangements for securing economy, efficiency and effectiveness (VFM).

We carried out the audit in accordance with the Code of Audit Practice for Local Government bodies as issued by the National Audit Office and delivered all expected outputs in line with the timetable established by the Accounts and Audit Regulations 2015 and the National Audit Office.

2015/16 has been another challenging year for the finances of the Council and like most other councils in the North East and across the country it has made some tough decisions on spending priorities and plans for the future. We reflect on these matters in the value for money part of this letter. However, we were pleased to issue an unqualified opinion on the statement of accounts and the value for money conclusion.

I would like to express my thanks for the assistance of the Council's finance team, as well as senior officers and the Audit Committee, during the audit.

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
Partner
Mazars LLP

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01 Key messages

In 2015/16 our audit of Durham County Council (the Council), including the Pension Fund, was made up of the following elements:

- auditing your financial statements;
- assessing arrangements for achieving value for money (VfM) in your use of resources;
- auditing the Whole of Government Accounts (WGA) consolidation pack; and
- reviewing the Durham County Council Pension Fund (The Fund) annual report for consistency with the Fund's accounts included in the Council's financial statements.

We reported the detailed findings from our audit work to those charged with governance in our Audit Completion Reports and update letters on 30 September 2016.

The key conclusions for each element are summarised below.

Audit of the financial statements

We issued an audit report including an unqualified opinion on the Council's financial statements, including Durham County Council Pension Fund on 30 September 2016. Further details are provided in section 02 of this letter.

Value for money

We carried out sufficient, relevant work, in line with the National Audit Office's guidance, so we could conclude on whether you had in place proper arrangements to secure economy, efficiency and effectiveness in your use of resources for 2015/16.

We issued an unqualified VFM conclusion on 30 September 2016.

Whole of Government Accounts

We provide assurance to the National Audit Office (NAO), as the auditor of central government departments, in relation to the consistency of your WGA consolidation pack with the audited statement of accounts. We reported that your consolidation pack was consistent with the audited statement of accounts on 30 September 2016.

Audit of financial statement included in Pension Fund Annual Report

We issued an unmodified consistency report on the financial statements included in the Fund's annual report on 30 September 2016.

Our other responsibilities

As the Council's appointed external auditor, we have other powers and responsibilities as set out in the Audit and Accountability Act 2014. These include responding to questions on the accounts raised by local electors as well as a number of reporting powers such as reporting in the public interest. We did not receive any formal objections or questions in relation to the 2015/16 accounts from local electors and we did not need to exercise our wider reporting powers.

02 Financial statements

Audit of the financial statements

We audited the financial statements in line with auditing standards and we reported the detailed findings of the audit in our Audit Completion Report to the Audit Committee on 30 September 2016 which, together with the follow up letter we issued, provides more detail of the work we have undertaken as the Council's external auditor in 2015/16. We issued an audit report, including an unqualified opinion, on the statement of accounts on 30 September 2016.

Our work on the Council's accounts is designed to provide reasonable assurance that they are free from material misstatement. The assessment of materiality is a key part of our work and we specify an overall materiality threshold, based upon 2% of the Council's gross revenue expenditure, together with lower materiality values for accounting entries we consider to be more sensitive, for example senior officer's remuneration. We consider materiality when planning and performing our work and in assessing audit results.

At the planning stage, we made a judgement about the size of misstatements which we would consider to be material and which gave 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. We updated our materiality calculation when we received the draft accounts and set the overall level at £24.9 million. Owing to an error identified which impacted on gross revenue expenditure, final materiality was updated to £24.6m. Appendix A provides more information on our approach.

Having considered the risks of material misstatement, we identified four areas of significant risk for the Council. These risks and our findings are summarised below:

Management override of controls

Description of the risk

In all entities, 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 addressed this risk

We addressed this risk by completing the following audit procedures:

- reviewing accounting estimates affecting amounts included in the financial statements;
- reviewing and considering any significant transactions outside the normal course of business; and
- applying a risk based approach to journals recorded in the general ledger and other adjustments made in preparation of the financial statements.

Audit conclusion

Our audit work provided the assurance we sought and did not highlight any issues in this area to report.

Revenue recognition

Description of the risk

There is a risk of fraud in financial reporting relating to income recognition due to the potential to inappropriately record revenue in the wrong period. ISA 240 allows the presumption of fraud relating to revenue recognition to be rebutted in exceptional circumstances, but given the Council's range of revenue sources we have concluded that there are insufficient grounds for rebuttal in 2015/16.

How we addressed this risk

We considered the design and implementation of controls to mitigate the risk of income being recognised in the wrong period. In addition, we completed a number of substantive procedures including:

- testing revenue items recorded in the General Ledger in March, April and May 2016 to ensure they have been recognised in the correct accounting period;
- testing adjustment journals;
- testing debtors; and
- agreeing major grant income to third party documentation.

Audit conclusion

Our audit work provided the assurance we sought and did not highlight any issues in this area to report.

Pension liability

Description of the risk

The financial statements contain material pension entries in respect of the retirement benefits. The calculation of these pension figures, both assets and liabilities, can be subject to significant volatility and includes estimates based upon a complex interaction of actuarial assumptions. This results in an increased risk of material misstatement.

How we addressed this risk

We completed the following audit procedures:

- evaluating the Council's arrangements (including relevant controls) for making estimates in relation to pension entries within the financial statements; and
- considering the reasonableness of the Actuary's assumptions that underpin the relevant entries made by the Council in its financial statements, through the use of an expert commissioned by the National Audit Office.

Audit conclusion

Our audit work provided the assurance we sought and did not highlight any issues in this area to report.

Accounting for LSVT

Description of the risk

In April 2015 the Council transferred its housing stock to County Durham Housing Group. The accounting treatment for the transfer of the housing stock is material and potentially complex. In particular the accounting treatment for the disposal of the assets and write off of HRA debt.

How we addressed this risk

We completed the following audit procedures:

- evaluating the design of the entity's related controls and determined whether they had been implemented; and
- reviewing the accounting entries for the disposal of the assets and write off of HRA debt.

Audit conclusion

Our audit work provided the assurance we sought and did not highlight any issues in this area to report.

We also identified one area of key management judgement:

Valuation of property, plant and equipment (PPE)

Description of the area of management judgement

The financial statements contain material entries on the Balance Sheet as well as material disclosure notes in relation to the Council's holding of PPE.

The value of the Council's PPE is material to the accounts and involve management judgements over the valuations and useful lives of assets.

How we addressed this area of management judgement

We addressed this management judgement with the following procedures:

- considering the Council's arrangements for ensuring that PPE values are reasonable;
- engaging our own expert to provide data to enable us to assess the reasonableness of the valuations provided by the Council's Valuer;
- assessing the competence, skills and experience of the Valuer; and
- reviewing a sample of individual assets to ensure that the basis and level of valuation was appropriate.

Audit conclusion

Our audit work provided the assurance we sought and did not highlight any issues in this area to report.

Preparation of the accounts

The Council presented us with draft accounts by the 30 June 2016, in accordance with the national deadline. Working papers and other supporting evidence were produced in a timely manner throughout the audit.

Issues arising from the audit of the accounts

We presented the detailed findings from our audit in our Audit Completion Report and update letter which we presented to the Audit Committee on 30 September 2016. The main findings are summarised as follows:

- Good quality draft financial statements and working papers were provided by the Council.
- The Council amended one error which resulted in both gross expenditure and gross income reducing by £15.4m. This related to the incorrect treatment of Better Care Fund income and expenditure. This had no impact on the Council's net cost of services.
- There was a material adjustment to the cash flow statement disclosures. This related to the incorrect treatment of a government grant associated with the repayment of borrowing following the housing stock transfer.
- There were no material errors that impacted upon the Council's General Fund balance.
- All errors were corrected other than five non-material misstatements that management assessed as not being material either individually or in aggregate to the financial statements. These are detailed in section 4 of our Audit Completion Report.
- Our work also identified some disclosure errors, which the council amended.
- Some significant deficiencies in internal controls were identified during the course of the audit (our work is not intended to express an opinion on the effectiveness of the system of internal control). These deficiencies, along with management responses, were reported to the Audit Committee. In particular, we reported in our ACR that an employee folder was not located for one individual selected in our substantive testing. Following publication of our ACR officers did locate the folder. This was verbally updated to members of the Audit Committee on the 30 September 2016.
- The audit progressed well and there were no significant difficulties encountered. We received the full co-operation of officers.

Annual Governance Statement (AGS)

The AGS is drafted by the Council to provide assurance to the reader over how it is managed and how it has dealt with risks in the year. We reviewed the AGS to see whether it complied with relevant guidance and whether it was misleading or was inconsistent with what we know about the Council. We found no areas of concern to report in this context.

Audit of the financial statements: Durham County Council Pension Fund

The overall materiality threshold of the Fund was £11.2 million. This was based upon 10% of the Fund's contributions receivable.

We reviewed the financial statements included in the Fund's annual report and issued a 'consistent with' opinion on 30 September 2016.

Having considered the risks of material misstatement, we identified four areas of significant risk for the Fund. Our findings are summarised below:

Management override of controls

Description of the risk

International Standards on Auditing 240 – *The auditor's responsibility to consider fraud in an audit of financial statement* (ISA 240) requires us to consider the potential for management override because controls that may be sufficient to detect error may not be effective in detecting fraud.

In all entities, management at various levels within an organisation is 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 addressed this risk

We addressed this risk by:

- reviewing accounting estimates affecting amounts included in the financial statements;
- reviewing and considering any significant transactions outside the normal course of business; and
- applying a risk based approach to journals recorded in the general ledger and other adjustments made in preparation of the financial statements.

Audit conclusion

Our audit work provided the assurance we sought and did not highlight any issues in this area to report.

Valuation of unquoted investments for which a market price is not readily available

Description of the risk

As at 31 March 2016, the fair value of investments which were not quoted on an active market was £496 million, which accounted for 21% of the Fund's net investment assets. As prices for these investments are not quoted in active markets, the values used in the accounts are those provided by fund managers mostly based on Net Asset Value statements, although in some cases are based on forward looking estimates and judgements involving many factors. This results in an increased risk of material misstatement.

How we addressed this risk

In addition to our standard programme of work in this area we completed the following tests:

- reviewed the management controls in place to assess the reasonableness of the valuation;
- agreed holdings from fund manager reports to the global custodian's report;
- agreed the valuation to supporting documentation including investment manager valuation statements and cashflows for any adjustments made to the investment manager valuation;
- agreed the investment manager valuation to audited accounts. Where these were not available, agreed the investment manager valuation to other independent supporting documentation;
- where audited accounts were available, checked that they are supported by a clean opinion; and
- agreed the price to independent evidence, for those valuations not supported by valuation statement.

Audit conclusion

Fund managers estimate the value of unquoted investments based on the best available information of the year end value at the time the financial statements are prepared. At the time of audit, additional information was available to fund managers relating to the year-end value of investments which was not available at the time the financial statements were prepared. This timing issue is unavoidable due to the time constraints on fund managers providing information for inclusion in the financial statements.

The most recently available information was used to review the investments included in our sample testing, to allow us to ascertain whether the most up to date information highlighted a risk of material misstatement. For the sample tested, information provided by fund managers indicated a higher net asset value of £0.77 million than the estimates included in the financial statements. Our extrapolation indicated a potential difference of £0.83 million if the sample results were true for the whole population. We consider the extrapolation does not indicate a risk of material misstatement.

Actuary's report disclosure

Description of the risk

The funding arrangements disclosure note sets out the key elements of the funding policy and key information regarding the most recent triennial valuation as at 31 March 2013, including contributions to be paid by participating bodies to allow the fund to achieve 100% solvency over 18 years. While there are no accounting entries associated with this disclosure, the triennial valuation determines future employer contribution rates and the disclosure itself is material. The calculation of these figures can be subject to significant volatility and includes estimates based upon a complex interaction of actuarial assumptions. There is a risk of material misstatement due to high estimation uncertainty.

How we addressed this risk

In addition to our standard programme of work we:

- reviewed the management controls in place over the source data;
- considered the reasonableness of the actuary's output, using our expert's report on all actuaries nationally which is commissioned annually by the National Audit Office; and
- reviewed source data on a sample basis.

Audit conclusion

Our audit work provided the assurance we sought and did not highlight any issues in this area to report.

Issues arising from the audit of the accounts: Durham County Council Pension Fund

We presented the detailed findings from our audit of the Fund in a separate Audit Completion Report and update letter at the Audit Committee on 30 September 2016. These findings are summarised as follows:

- Good quality draft financial statements and working papers were provided by the Council.
- Our work identified few errors, with no material errors that impacted upon the Fund's Net Assets.
- All errors were corrected other than two non-material misstatements that management assessed as not being material either individually or in aggregate to the financial statements.
- We identified one significant deficiency in internal controls during the course of the audit in relation to the classification of investments. This resulted in significant amendments to the draft accounts. This is detailed in section 4 of our Audit Completion Report. Going forward, officers plan to interrogate the quarterly reports in order to identify investments which require reclassifying prior to posting transactions to the ledger. In addition, the recommendations made to the Council based upon our work on the Council's IT controls, were relevant to the Fund.
- The audit progressed well and there were no significant difficulties encountered. We received the full co-operation of officers.

03 Economy, efficiency and effectiveness

We are required to conclude whether Durham County Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We undertook our work in this area in accordance with the guidance set out by the National Audit Office (NAO) by considering one overall criterion which is made up of three sub-criteria.

The overall criterion set out by the NAO is:

‘In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.’

The three sub-criteria are set out below.

Sub-criteria	Guidance
Informed decision-making	<ul style="list-style-type: none"> Acting in the public interest, through demonstrating and applying the principles and values of sound governance. Understanding and using appropriate and reliable financial and performance information (including, where relevant, information from regulatory/monitoring bodies) to support informed decision making and performance management. Reliable and timely financial reporting that supports the delivery of strategic priorities. Managing risks effectively and maintaining a sound system of internal control.
Sustainable resource deployment	<ul style="list-style-type: none"> Planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions. Managing and utilising assets effectively to support the delivery of strategic priorities. Planning, organising and developing the workforce effectively to deliver strategic priorities.
Working with partners and other third parties	<ul style="list-style-type: none"> Working with third parties effectively to deliver strategic priorities. Commissioning services effectively to support the delivery of strategic priorities. Procuring supplies and services effectively to support the delivery of strategic priorities.

Significant risks

We continued to revisit our value for money risk assessment throughout the audit. We identified no significant risks relevant to the value for money conclusion. We did identify areas where we believed additional work was necessary to fully understand the Council’s arrangements. This additional work focused on the Council’s Medium Term Financial Plan (MTFP) and the Better Care Fund arrangements. Our additional work identified no issues that suggested a weakness in arrangements.

A summary of our findings against each sub-criteria and our overall assessment is set out in the sections that follow.

Informed decision-making

Proper arrangements	Commentary
Acting in the public interest, through demonstrating and applying the principles and values of sound governance	<p>The Council has an established Constitution which is subject to regular review. This clearly details the governance structure of the Council.</p> <p>The Council has an active Audit Committee.</p>
Understanding and using appropriate and reliable financial and performance information (including, where relevant, information from regulatory/monitoring bodies) to support informed decision making and performance management.	<p>The Council produced regular finance reports which were presented throughout the financial year to the Cabinet. This is supported by monthly budget monitoring by management. The council's financial position, including delivery of Medium Term Financial Plan savings, have been clearly reported throughout the year. This reporting has allowed the Council to continually report and deliver a surplus in 2015/16.</p> <p>Performance reports have also been produced in a timely manner and there are robust arrangements in place for collecting and reporting performance. Performance measures are linked to the Altogether priority themes and are intended to measure service delivery against the background of increasing demand on services and falling resources.</p> <p>Performance indicators are reviewed by officers and members to ensure those used are still relevant.</p>
Reliable and timely financial reporting that supports the delivery of strategic priorities.	<p>As above the Council continues to produce regular finance reports which are presented throughout the financial year to the Cabinet. The year-end position is not significantly different to that forecast during the year.</p>
Managing risks effectively and maintaining a sound system of internal control.	<p>The Council has a Corporate Risk Management Group which has senior officer and member representation. Risks are identified and linked to the Council Altogether Corporate Themes. Actions to help mitigate each risk are identified and reported. The Council has an active Audit Committee which receives regular strategic risk management updates.</p> <p>The Council has a comprehensive Internal Audit plan and Internal Audit provide reports at each Audit Committee meeting.</p>

Sustainable resource deployment

Proper arrangements	Commentary
<p>Planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions.</p>	<p>Robust budgetary control arrangements mean the council delivered a surplus in 2015/16 financial year, with all services reporting cash limit underspends at the year end. This included delivery of £16.3million savings. The final outturn for was presented to Cabinet on the 13 July 2016 with quarterly forecast outturn reports being presented to Cabinet throughout the year.</p> <p>The Council has a Medium Term Financial Plan (MTFP) which is regularly reviewed and updated. Regular updates on MTFP have also been presented to Cabinet members. Additionally, where required, service reviews have been considered by the relevant Scrutiny Committees. MTFP (6) forecasts savings of £104.3million between 2016/17 -2019/20. The council has already delivered £153.2million of savings between 2011/12 and 2015/16 which will mean by the end of 2019/20 the council will have achieved savings of £257.5million.</p> <p>Robust planning arrangements mean the Council identifies savings in advance of any financial year. The latest plan, MTFP (7), covering the 2017/18-2019/20, was presented to Cabinet in July 2016. The delivery of MTFP savings continues to be the number one risk in the Councils Strategic Risk Register. The Council's Big Board arrangements mean savings plans have been identified for 2017/18. Plans for 2018/19 are currently being initiated at service level and will be presented to members in early 2017.</p> <p>The councils Transformational Programme will sit alongside the current arrangements. The first Transformation Board met in September 2016 to determine its terms of reference. The Board has representatives from Corporate Management Team and Cabinet, this alongside the appointment of Director for Transformation and Partnerships, means the programme has prominence within the Council.</p>
<p>Managing and utilising assets effectively to support the delivery of strategic priorities.</p>	<p>Through prudent financial management, at 31 March 2016, the Council reserves were:</p> <ul style="list-style-type: none"> • General Fund balance - £29.1 million • Earmarked Reserves - £241.6 million (including £36.3 million school related reserves) <p>The levels are intended to help the Council manage the impact of expected future reductions in funding and reserves. The Council has planned to utilise reserves in a structured way to support future MTFP's. This includes use of the Budget Support Reserve to support delivery of the MTFP in 2016/17 and 2017/18. The Budget Support Reserve at the 31 March 2016 had a balance of £30.0million.</p> <p>Budget setting arrangement mean the Council regularly review earmarked reserves. Where reserves, previously earmarked for specific schemes, are no longer relevant the reserve is released and used to support pressures.</p> <p>The Council has a capital plan in place.</p>

Proper arrangements	Commentary
Planning, organising and developing the workforce effectively to deliver strategic priorities.	<p>There has been significant levels of employees leaving the council in recent years. In 2016/17 the Council is forecasting a further reduction of 400 posts including the deletion of 60 anticipated vacant posts.</p> <p>The council continues to survey staff and monitors staff sickness levels for any indication of changes in overall morale. The Council also monitors service performance which may drop as a result of inappropriate staffing levels.</p> <p>Performance is monitored against the Council's Altogether priorities. Service groupings review workforce reduction. Recommendations made in the recent Ofsted report, regarding staffing levels, are being addressed through the Improvement Action Plan which is monitored by the Quality Improvement Board.</p> <p>Equality Impact Assessments (EIA) are seen as an essential part of the development of savings. EIA ensure the lawfulness and fairness of savings are considered. Assessments look at the impact to service users and staff of any potential savings. EIA's are available to members to inform their decisions on savings proposals.</p>

Working with partners and other third parties

Proper arrangements	Commentary
Working with third parties effectively to deliver strategic priorities.	<p>The Council has a track record of working with partners. Area Action Partnerships are in place and allow the Council to work with local residents and organisations. Through the County Durham Partnership the Council works other organisations and partnerships to promote and develop County Durham.</p> <p>The Health and Wellbeing Board has oversight of the Better Care Fund (BCF) and receives quarterly updates on performance and financial information. The BCF is managed through a joint board to ensure balanced working between the parties. A Joint Finance Group, including appropriate Finance representation from the three partner organisations, meets on a regular basis to review financial information to support the reporting process.</p> <p>The Council is a member of the North East Combined Authority. At the time of our report proposals for further devolution in the region was uncertain given a decision on the 6th September 2016. Arrangements in place should ensure the MTFP is updated for any significant changes which may impact on the Council through any future decision. The Strategic Risk Management has also identified devolution as an emerging risk and one being monitored by the Council.</p>
Commissioning services effectively to support the delivery of strategic priorities.	The Council Constitution details the arrangements for contracting with third parties.
Procuring supplies and services effectively to support the delivery of strategic priorities.	The Council Constitution details the arrangements for contracting with third parties.

Overall assessment ('reality check')

Having gathered evidence of the Council's arrangements for each of the sub-criterion we conducted a 'reality check', building upon our existing knowledge of the Council and considering the robustness of our assessment by referring to:

- reports by statutory inspectorates or other regulators;
- achievement of performance and other targets; and

- performance against budgets and other financial targets.

Evidence	Auditor assessment
Reports by statutory inspectorates or other regulators	<p>In 2015/16 the Council received an overall 'requires improvement' rating from Ofsted. This followed an inspection of Children's Services and the Local safeguarding Children's Board. This rating was a fall from the previous 'good' score the Council had received at its last inspection. Whilst the Ofsted report identified areas of good performance it made 14 recommendations for improvement.</p> <p>We reviewed the arrangements put in place by the Council following the inspection. The Council have implemented an Improvement Action Plan. The plan covers each of the identified recommendations and identifies actions that the service will take, assigns a lead officer to each action, a start and end date, key milestones and the expected outcome. The Plan is being monitored by the Quality Improvement Board (QIB) which was established before the inspection. The QIB has senior officer and member representation. Our review identified that arrangements have been put in place by the Council to manage the result of the Ofsted Inspection.</p> <p>We reviewed the value for money profiles (based on data from Public Sector Audit Appointments). Based on this review, there were no indicators which would suggest weaknesses in the Council's arrangements, or any information contrary to our knowledge of the Council.</p>
Achievement of performance and other targets	We reviewed the latest performance reports and identified no matters suggesting a weakness in the Council's arrangements or any information contrary to our knowledge of the Council.
Performance against budgets and other financial targets	The Council has a history of achieving budget targets.

Overall Conclusion

We satisfied ourselves that, in all significant respects, the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2016 and we issued an unqualified VFM conclusion.

04 Future challenges

Financial challenges

The challenges facing the Council in the next few years are not insignificant. The Council has placed itself in as strong a position as possible, having made good progress in addressing its biggest challenges to date and having a track record of strong budget management and delivering planned budget reductions.

Reductions in funding will have an impact on the Council's future budgets. The Council's budget for 2015/16 reflected £16.3 million of savings, which were achieved. In 2016/17 savings are forecast as £28.3 million with a further £64.1 million of savings being required to balance the budget over the 2017/18 to 2019/20 period. The overall savings requirement for the period from 2011/12 to 2019/20 will be £257 million. Robust arrangements mean the Council have made significant savings since 2011.

In the coming years some of the challenges facing the council will include:

- Further reductions in government funding, although the Council have submitted an Efficiency Plan to access the four year funding settlement;
- 100% business rates retention and fair funding assessments (not anticipated till 2019);
- Impact of the European Union referendum vote (Brexit);
- Increases in pay and price inflation above the MTFP assumptions; and
- Increases in demographics and demand on services, for example Adult Social Care.

With a financial outlook that is increasingly challenging the Council will need to continue to:

- carefully forecast and effectively monitor budgets;
- identify and address financial pressures as they emerge;
- deliver a long term financial strategy that addresses immediate pressure while allowing scope for strategic service change;
- maintain effective arrangements for public engagement; and
- use constructive relationships with partners to safeguard service quality and resilience.

Other Challenges

We will focus our 2016/17 audit on the risks that your challenges present to your financial statements and your ability to maintain proper arrangements for securing value for money. We will also share with you relevant insights that we have as a national and international accounting and advisory firm with experience of working with other public sector and commercial service providers.

In terms of the technical challenges that officers face around the production of the statement of accounts, we will continue to work with them to share our knowledge of new accounting developments and we will be on hand to discuss any issues as and when they arise. A key area in this respect includes working with officers as they make preparations for highways infrastructure on a fair value accounting basis as required by the accounting Code. This will require significant changes in the 2016/17 statements and we are already working with officers to determine the impact of this change and to ensure the required systems are in place.

Looking further ahead, from 2017/18 the Council will be required to produce their accounts by the 30 May, rather than the 30 June. The audit deadline will also move from the 30 September to the 30 July. This will place pressures on Council officers. We will continue to work with officers to help ensure the Council is ready for this change. This includes an agreed early close down and audit in 2016/17.

05 Fees and closing remarks

Fees

Public Sector Audit Appointments Ltd (PSAA) sets a scale fee for our audit and certification work. The fees applicable to our work in 2015/16 are summarised below.

Element of work	2014/15 Final Fee	2015/16 As previously reported	2015/16 Final Fee
Code audit work – Durham County Council	£334,250	£250,688	£250,688
Certification work – Durham County Council	£32,210	£20,062	Note A
Code audit work – Durham County Pension Fund	£25,918	£25,918	£25,918

Note A: The fee outlined above in relation to certification work is the scale fee set by PSAA. As we are yet to complete our certification work on the Council's Housing Benefit claim. We will confirm the final fee charged when we issue our 2015/16 Certification Report later in the year.

In our Certification Report we will also report any certification work we have completed outside the PSAA contract. Currently we are certifying the Council's Teacher Pensions return. The fee for this work has been set in a range of £4,000 to £5,000 and is dependent on the time required to complete the certification work. The 2014/15 fee for the equivalent work was £4,850.

Closing remarks

During the audit year we have continued to support the Council in many ways, including:

- Attendance at Audit Committees where we inform the Committee about progress on the audit, report our key findings and update it about developments in the wider environment.
- Hosting events for staff, such as our Local Government financial statements workshops.

Further detailed findings, conclusions and recommendations in the areas covered by the audit are included in the reports issued to the Audit Committee during the year, which are summarised below.

Report	Date issued
2015/16 Audit Fee Letter	April 2015
Audit Strategy Memorandum	May 2016
Progress reports to Audit Committee	To each Audit Committee meeting
Audit Completion report	September 2016
Auditor's Report (opinion)	September 2016
Annual Audit Letter	October 2016

The Council has continued to take a positive and constructive approach to our audit. The 2015/16 audit is my final year as Engagement Lead of Durham County Council and Durham County Council Pension Fund. We would like to record our appreciation for the assistance and co-operation provided to us during our audit by finance staff. I wish to thank officers and members for their continued support and co-operation throughout my time as your engagement lead and I wish the Council every success for the future.

We will meet with the officers to identify learning from the 2015/16 audit and will continue to share our insights from other client and relevant knowledge from the wider public and private sector.

Should you require any further information, please do not hesitate to contact any member of the team.

Cameron Waddell

Partner

October 2016

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Appendix A - 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 assumed 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 considered materiality whilst planning and performing our audit.

Whilst planning, we made judgements about the size of misstatements which we considered to be material and which provided 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.

In 2015/16 we set materiality at the planning stage at £24.9 million (2% of gross revenue expenditure) with a clearly trivial threshold of £0.748 million below which identified errors will not usually be reported. We set lower materiality levels for the accounting entries we consider to be more sensitive, for example, senior officer's remuneration, as we considered these items to be of specific interest to users of the accounts sufficient to warrant audit procedures which would not otherwise be applied based on the materiality level for the audit as a whole. The materiality determined at the planning stage did not necessarily establish an amount below which uncorrected misstatements, either individually or in aggregate, would be considered as immaterial.

We revised materiality for the financial statements as our audit progressed. Our closing assessment of materiality in 2015/16, based upon the final version of the financial statements, was £24.6 million with a clearly trivial threshold of £0.739 million below which identified errors were not reported.

We discussed with management any significant misstatements or anomalies that we identified during the course of the audit and we reported in our Audit Completion Report all unadjusted misstatements we identified other than those which were clearly trivial, and obtained written representation that explained why these remain unadjusted.

This Annual Audit Letter is prepared in the context of the ‘Statement of responsibilities of auditors and audited bodies 2015-16’ issued by Public Sector Audit Appointments Ltd. It is addressed to the Audit Committee as those charged with governance of the Council. We, as appointed auditor, take no responsibility to any third party.

Mazars LLP is the UK firm of Mazars, an international advisory and accountancy organisation, and is a limited liability partnership registered in England with registered number OC308299. A list of partners’ names is available for inspection at the firm’s registered office, Tower Bridge House, St Katharine’s Way, London E1W 1DD.

We are registered to carry on audit work in the UK by the Institute of Chartered Accountants in England and Wales. Details about our audit registration can be viewed at www.auditregister.org.uk under reference number C001139861.

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