

Audit Progress Report 2021/22

London Borough of Harrow

September 2023



Purpose and contents

Purpose

This report follows the detailed Audit Completion Report on the audit of the Council's and Pension Fund's statement of accounts for the year ending 31 March 2022 that we presented to the May 2023 meeting of the Governance, Audit, Risk Management and Standards Committee (GARMS) and the short update to the July meeting. This report communicates to the Committee our subsequent progress against the work that remained in progress on both the Council and Pension Fund financial statement audits.

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01

Section 01:

**London Borough of Harrow Council
and Harrow Pension Fund - Audit
Progress Update**

Audit Progress

Financial Statements - 2021/22 audit

Harrow Council

During the execution phase of the audit, we identified several complex issues in how the Council had completed the valuation of its property, plant and equipment and investment property. In addition, the Council has had to account for its infrastructure assets in accordance with a change to the CIPFA Code and then consider the impact of the triennial valuation of the pension fund on its pension liability as at 31 March 2022. These issues required considerable audit time and effort to address. We have now substantially completed our work on these areas and are in process of agreeing with the Finance team the required amendments to the financial statements. We provide further details in Section 2.

However, we are awaiting final assurances from the pension fund auditor on their testing of the updated pensions membership data (see below).

Harrow Council Pension Fund

We have substantially completed the audit procedures on the data supporting the draft financial statements. The Pension Fund is currently completing work to provide assurance over the completeness of the membership data it submitted to the actuary for the triennial valuation.

As a result of these issues, there will be a delay in completion of the audit. We are endeavouring to complete the audits as soon as possible. Section 2 of this report provides details of our work in the context of the significant and enhanced risks to which they relate.

02

Section 02:

London Borough of Harrow Council – Progress on Significant Risks

Audit Progress

2021/22 Audit – Progress on Significant Risks (Council)

A significant risk is an identified and assessed risk of material misstatement that, in the auditor’s judgment, requires special audit consideration. For any significant risk, the auditor shall obtain an understanding of the entity’s controls, including control activities relevant to that risk. Risks 1-5 were identified and reported to the Committee in the Audit Strategy Memorandum dated 19 July 2022. Our risk assessment process is continuous, with risk 6 being subsequently identified and communicated in our Audit Progress Report dated September 2022.

	Description	Progress to date
1	<p>Management override of controls</p> <p>This is a mandatory significant risk on all audits due to the unpredictable way in which such override could occur.</p> <p>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 there is a risk of material misstatement due to fraud on all audits.</p>	<p>Subject to final internal review we have completed our planned procedures and have no issues to bring to the Committee’s attention.</p>
2	<p>Risk of fraud in revenue recognition</p> <p>The risk of fraud in revenue recognition is presumed to be a significant risk on all audits due to the potential to inappropriately shift the timing and basis of revenue recognition as well as the potential to record fictitious revenues or fail to record actual revenues.</p> <p>Based on our initial knowledge and planning discussions we have concluded that we can rebut the presumption of a revenue recognition risk for the majority of the Council’s revenue income and expenditure. In particular we can rebut the revenue recognition risk for income derived from Council Tax, main revenue Grants and NNDR due to the low inherent risk associated with these amounts.</p> <p>For the Council we deem the risk to relate specifically to material income streams within the Council, being fees, charges and other service income, where the level of inherent risk is higher.</p>	<p>We have completed our work and have no matters to report to the Committee.</p>

Audit Progress

2021/22 Audit – Progress on Significant Risks

	Description	Progress to date
3	<p>Valuation of net defined benefit pension liability</p> <p>The last triennial valuation of the Harrow Pension Fund was completed as at 31 March 2019. As an admitted body within the Fund, the valuation provides the basis of the associated net pension liability for the Council as at 31 March 2022.</p> <p>The valuation of the Council's net liability includes use of discount rates, inflation rates, mortality rates etc., all of which should reflect the profile of the Council's employees and other appropriate data.</p> <p>Due to the high degree of estimation uncertainty associated with these valuations, we have determined there is a significant risk in this area.</p>	<p>As a result of the national pensions issue, there has been a material amendment to the Council's net defined benefit pension liability. This misstatement is detailed in section 4 of this report.</p> <p>The 31 March 2022 triennial valuation provided more up to date information to support the estimation of the Council's net defined benefit pension liability. As a result, the Council were required to update this estimate based on the new information. Although we audited the initial estimate, we are required to audit this updated balance. An element of our procedures will require assurances from the pension fund auditor over the membership data used.</p> <p>The Pension Fund auditors have completed the additional work required on a sample of the membership data used to inform the triennial valuation. They did identify some issues with the initial sample that the Pension Fund were able to resolve. An additional sample has since been tested. The pension fund auditors are awaiting the Pension Fund to complete procedures to provide assurance over the completeness of its membership data.</p> <p>Once received we will complete our final review procedures.</p>
4	<p>Migration from SAP to D365</p> <p>During 2021/22, the Council has undertaken an accounting system migration from SAP to D365. In October 2021, the nominal ledger, accounts receivable and accounts payable functions were closed in SAP and became managed via Dynamics365 (D365). Payroll migrated in April 2022.</p> <p>There is a risk that the migration will not capture all transactions held in the prior system. The omission of such data could ultimately lead to material misstatement within the financial statements. The implementation of a new system also poses a significant risk to the integrity and validity of the Council's financial reporting if change management processes are not robust and the new system is not correctly tested and implemented.</p> <p>There is a further risk the migration leads to a loss of data and accounting records during transfer. Such a loss of data may result in a risk that during the audit, we are unable to obtain sufficient and appropriate third part evidence to support transactions entered into by the Council.</p>	<p>In support of our opinion on the 2021-22 financial statements, we performed detailed testing of the migration of data between SAP and D365. We have no issues to report arising from our planned audit work.</p> <p>We have reported findings in relation to our Value For Money work surrounding the Council's arrangements to maintain adequate historic accounting records. These are detailed in section 3 of this report – risk 2.</p>

Audit Progress

2021/22 Audit – Progress on Significant Risks

	Description	Progress to date
5	<p>Property, plant and equipment and investment properties valuations</p> <p>The Code requires that the carrying value should reflect the appropriate fair value as at the year end. As a result, a number of the Council's assets will be subject to revaluation at each year end to achieve this. Estimation of fair values is complex. This creates a risk that the carrying value of those assets revalued in the year are materially mis-stated.</p> <p>In line with the Code, the Council applied a 'rolling-programme' to revaluing its assets. The code dictates a maximum period for the number of years between full revaluations of assets. Where assets have not been revalued in the year, there is a risk there may have been a material movement in its value.</p> <p>In respect of Council Dwellings, these are reviewed using a beacon valuation methodology, which values Council stock by grouping assets into type and using a nominated beacon asset for each group. The assessed value is uplifted based on an open market assessment then amended for an adjustment factor provided by DHLUC.</p> <p>Due to the high degree of estimation uncertainty associated with valuations, we have determined there is a significant risk in this area.</p>	<p>As part of our initial procedures, we challenged the Council's valuation experts on to the methodologies that had been applied in valuing assets at 31 March 2022. This has resulted in further work by the Council's valuers identifying significant changes to the Council's valuations, resulting in several misstatements detailed in section 4.</p> <p>Our work reviewing whether assets not subject to full valuation during the year were materially misstated identified the requirement for a material amendment to the accounts. This is detailed in section 4.</p> <p>We are in the process of finalising our audit procedures and confirming that the Council has made the appropriate amendments to its financial statements.</p>
6	<p>Valuation of intangible assets</p> <p>Within the 2021/22 financial statements, the Council has included a material value in respect of intangible assets. This relates to the implementation of the new D365 accounting software and associated systems. This has been re-classified from assets under construction.</p> <p>Costs have been generated over a period of time and, in view of the complexity of the recognition criteria included in the accounting standards (IAS38 – Intangible Assets) and the level of management judgement involved in identifying items appropriate for capitalisation, we consider there to be a significant risk the valuation of the intangible asset could be materially misstated.</p>	<p>As a result of our planned procedures, we identified a number of items which, although included within the intangibles balance, had been incorrectly classified. We have discussed the issue with the Council and requested they analyse the intangibles population, to ensure that all costs capitalised met the requirements of IAS 38 - Intangible Assets. This has resulted in a reduction in value of the intangible asset. We include this misstatement in section 4.</p> <p>We are in the process of finalising our audit procedures and confirming that the Council has made the appropriate amendments to the financial statements.</p>

03

Section 03:

**London Borough of Harrow Council –
Progress on Value for Money (VFM)**

3. Value for money

Value for Money (VFM)

Auditor VFM responsibilities - 2020/21

Due to the ongoing Police criminal investigation, we have been unable to conclude our review of the Council's Value for Money arrangements for the 2020/21 financial period. We will also be unable to conclude on the Council's value for money arrangements for the 2021/22 financial period until the Police investigation is complete.

Auditor VFM responsibilities - 2021/22

In May 2023 we reported the status of our VFM work where we determined that there was no significant weakness relating to financial sustainability.

We also reported on two risks of significant weakness:

1. Coverage of internal audit work
2. Governance relating to data migration

We discussed both risks with Members and have carried our further enquiries with management. We include an update on our work in relation to the governance of the data migration and the outstanding management actions to support a conclusion to our work.

3. Value for Money

Risk 1 – Effectiveness and coverage of internal audit

We identified a risk of significant weakness in the Council’s governance arrangements for how it ensures that it makes informed decisions and properly manages its risks, including specifically how it gains assurance over the effective operation of internal controls, including arrangements to prevent and detect fraud.

We have since identified a significant weakness in the Council’s governance arrangements. The weakness relates to the extent of coverage internal audit have performed for the financial years 2021/22 and 2022/23 to date.

During 2021/22 the Council diverted Internal Audit (IA) resources onto an investigation into the fraud that arose in 2020/21. As a result, internal audit were unable to deliver the audit plan that had previously been approved. Only five reviews from the original 44 planned were completed.

For 2021/22 the Head of IA has issued an opinion of ‘Good with some significant improvements required in a few areas’ based on the completed reviews. We have considered the reports issued by IA. Of the five reports completed, one provided red assurance, two provided red/amber assurance, one amber/green and one green. The remainder of the 21/22 programme, being 39 reviews, was deferred to 22/23. We do not believe the work completed was sufficient to support an overall opinion.

We have reviewed the draft Internal Audit and Corporate Anti-Fraud work plan for 2022-23 that was presented to the committee in July 2022. This includes a programme of 38 reviews, 13 are carried forward from 2021-22. This means of the 28 reviews not completed in 2021-22, less than half, have been built into the following years plan.

Whilst we understand the resourcing challenges faced by IA and the impact of the 2020/21 fraud, the limited IA coverage for 2021/22 meant that potentially elevated areas of risk, such as the change in the general ledger and the associated migration and control charges, were not reviewed by IA.

The Director of Finance and Assurance is responsible for ensuring an effective internal audit function is resourced and maintained.

Update

Following the May 2023 GARMS meeting the Director of Finance and Assurance provided a detailed response to our findings. We have reviewed the response and discussed it with the Interim Director of Finance and Assurance.

The Interim Director of Finance and Assurance acknowledges that the Internal Audit plan was not completed in 2021/22 based on the view of the then Head of IA that taking account of other means of assurance alongside the reviews that were completed was sufficient to enable the Head of IA to provide an opinion on the Council’s internal control, risk management and governance arrangements.

Based on the above update, we remain of the view that this matter is a significant weakness in respect of the Council’s governance arrangements, specifically how the Council monitors and assesses risks and how the Council gains assurance over the effective operation of internal controls. We will include the matter in our final audit report.

Recommendation

We recommend management ensure subsequent Head of Internal Audit opinions are supported by an adequate programme of work. We would encourage management to ensure the plan is flexed to provide coverage over both emerging risks and a wide range of the Councils activities. We would also recommend the Council ensure Internal audit is adequately resourced to be able to deliver the required annual programme of work.

The Interim Director of Finance and Assurance has accepted the recommendation and will provide a formal response for our final reporting on the 2021/22 audit.

3. Value for Money

Risk 2 – Governance of the ledger migration, the requirement to maintain adequate historic records

We identified a risk significant weakness in respect of the Council's governance of the implementation of its new ledger system. Whilst our financial audit procedures confirmed the migration of 21/22 records was complete and accurate, this risk is specific to the requirement to maintain adequate accounting records for periods prior to 2021/22. In our view, the potential weakness identified could lead to non-compliance with statutory requirements in relation to maintaining adequate historic accounting records.

We identified that the Council had not performed any form of validation testing of stored historic data to confirm records from the required periods prior to 2021-22 were sufficient to be compliant with laws and regulations. This is compounded by the issue that SAP had been fully decommissioned and was no longer accessible. Should the Council identify deficiencies in this historic data, they will not be able to recover original records from SAP.

Whilst the Council has since performed some mitigation testing on the 2 most recent years' worth of data, it is yet to be shared with the audit team. The Council have also noted that the statutory requirement to maintain adequate historic records is mandated by HMRC to ensure compliance with any potential tax inspection.

Update

Since the May 2023 GARMS meeting the Council have provided narrative stating they have been subject to an HMRC business review and were able to provide sufficient records to comply with this review.

However, the Council has yet to provide sufficient appropriate evidence that HMRC are satisfied with its historic record keeping. Based on the above we reiterate the recommendations we made in the May 2023 report and these will be included as a

significant weakness in the Council's governance arrangements in our final audit report on the 2021/22 accounts.

Recommendations

We recommend that the Council completes a full validation exercise of all the data that has been transferred to the cloud-based storage solution to mitigate the risk of non-compliance with laws and regulations in respect of maintaining adequate accounting records.

We also recommend that the Council reviews its governance processes surrounding any future system changes to ensure data migration risks are properly assessed and mitigated by appropriate validation, testing.

04

Section 04:

**London Borough of Harrow Council –
Updated summary of misstatements**

4. Summary of misstatements

This section outlines the latest misstatements identified during the course of the audit, above the trivial threshold for adjustment of £353,000. The first table outlines the misstatements that were identified during the course of our audit which management has assessed as not being material either individually or in aggregate to the financial statements and does not currently plan to adjust.

The second table outlines the misstatements that have been adjusted by management during the course of the audit. There have also been associated disclosure amendments which have not been reported within this schedule. We will update these tables on conclusion of the audit.

Unadjusted misstatements – no changes to May 2023 Audit Completion Report

	Comprehensive Income and Expenditure Statement		Balance Sheet	
	Dr (£'000)	Cr (£'000)	Dr (£'000)	Cr (£'000)
1 DR Expenditure (CIES - HRA) CR Income (CIES - HRA)	983	983		
HRA income and expenditure figures are based on data in Northgate. These require manual adjustment in order to align figures between the CIES and subjective analysis, with the difference being driven by time lags between Northgate and the general ledger.				
2 DR Other operating income CR Financing and investment income	701	701		
Extrapolated adjustment required to amend for the incorrect classification of property disposals				
3 DR Income - Grants within CIES CR Short Term Debtors		1,013	1,013	
Extrapolated adjustment for cut-off error where revenue grant for activities in period 2021/22 had been incorrectly recorded in 2022/23 financial statements rather than accrued for at year end of 2021/22.				
unadjusted misstatements c/f	1,684	2,697	1,013	-

4. Summary of misstatements

	Comprehensive Income and Expenditure Statement		Balance Sheet	
	Dr (£'000)	Cr (£'000)	Dr (£'000)	Cr (£'000)
Total unadjusted misstatements b/f	1,684	2,697	1,013	-
4 DR - Income CR - Expenditure	3,394	3,394		
Extrapolated adjustment for misstatements within the D365 fees and service charges income population, which had resulted in re-charges being incorrectly journalled and corresponding overstatements of both income and expenditure.				
Total unadjusted misstatements	5,078	6,091	1,013	-

4. Summary of misstatements

Adjusted misstatements – no change to May 2023 ACR

		Comprehensive Income and Expenditure Statement		Balance Sheet	
		Dr (£'000)	Cr (£'000)	Dr (£'000)	Cr (£'000)
1	DR Expenditure (community) CR Income (community)	8,794	8,794		
Adjustment arising due to a selection of nominal ledger codes being misclassified within the CIES.					
2	DR Income (resources) CR Expenditure (resources)	5,959	5,959		
Adjustment arising due to a cost centre being incorrectly mapped as an agency arrangement					
3	DR Expenditure (Adult services)	489			
	DR Expenditure (Children and families)	620			
	DR Expenditure (Community)	2,363			
	DR Expenditure (Resources)	787			
	CR Income (Adult services)		489		
	CR Income (Children and families)		620		
	CR Income (Community)		2,363		
	CR Income (Resources)		787		
Adjustment arising due to incorrect subjective analysis resulted in the misallocation of a number of codes in the CIES.					
4	DR PPE additions CR PPE re-classifications			7,626	7,626
Disclosure amendment to adjust Inventory balances incorrectly netted off against additions					
Total adjusted misstatements c/f		19,012	19,012	7,626	7,626

4. Summary of misstatements

Adjusted misstatements – no change to May 2023 ACR

	Comprehensive Income and Expenditure Statement		Balance Sheet	
	Dr (£'000)	Cr (£'000)	Dr (£'000)	Cr (£'000)
Total adjusted misstatements b/f	19,012	19,012	7,626	7,626
5 DR Pension reserve CR Long term liabilities			2,278	2,278
Adjustment due to initial schedule of IAS19 disclosures being based on 31/12/21 asset valuations rather than 31/3/22.				
6 DR PPE CR Intangibles			3,951	3,951
Adjustment due to the misclassification of tangible assets within intangible assets				
7 DR Expenditure (Resources) CR Income (Resources)			593	593
Adjustment due to incorrect classification of a cost centre as agency rather than included within the financial statements of the council				
8 DR Assets under construction (PPE) DR Assets Held for Sale CR Inventories			3,989 7,661	11,650
Adjustment for the re-classification of inventories between assets under construction and assets held for sale.				
9 Dr: Expenditure (CIES - HRA) Cr: Property, Plant & Equipment (HRA) Dr: Reserves (CAA / Revaluation) Cr: CIES (adjustments to resources)		28,980	28,980	28,980
Total adjusted misstatements c/f	47,992	47,992	55,078	55,078

4. Summary of misstatements

Adjusted misstatements – New

		Comprehensive Income and Expenditure Statement		Balance Sheet	
		Dr (£'000)	Cr (£'000)	Dr (£'000)	Cr (£'000)
Total adjusted misstatements c/f		47,992	47,992	55,078	55,078
10	Dr: Investment properties Cr: Finance and investment income		527	527	
TBC – Awaiting finalisation of work on Property and Investment Property valuations.					
11	Dr: Property, plant and equipment (surplus assets) Cr: Property, plant and equipment (other land and buildings)			6,100	6,100
A small number of the Council's assets included in the classification of other land and buildings were no longer providing a service potential to the Council and were surplus to requirements.					
12	Dr: Revaluation reserve Dr: Expenditure (CIES – Children and families) Cr: Property, plant and equipment	6,555		11,118	17,673
Downward valuation to the Council's property, plant and equipment portfolio due to the application of inappropriate valuation methodologies.					
13	Dr: Revaluation reserve Cr: Property, Plant & Equipment			25,730	25,730
Downward valuation adjustment to the Council's property, plant and equipment portfolio because of the failure to re-value the Council hub.					
14	Dr: Pension reserve Cr: Net defined benefit pension liability			27,600	27,600
Amendment to the IAS19 net defined benefit pension liability because of the update to the estimate due to the availability of more up to date membership data.					
Total adjustments		54,547	48,519	126,153	132,181

Suresh Patel, Partner

Mazars

30 Old Bailey
London
EC4M 7AU

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