

# Audit Progress Report 2021/22

London Borough of Harrow

November 2022



# Purpose and contents

## Purpose

We have prepared this report to communicate to the Governance, Audit, Risk Management and Standards Committee (GARMS) our progress with auditing the Council's statement of accounts for the year ending 31 March 2022 and an update on the significant risks identified in relation to the audit of both the Council and Pension Fund financial statements. In addition, we wish to highlight some national publications which the Committee may find useful in enabling them to discharge their role as those charged with governance of the Council.

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# 01

Section 01:

**London Borough of Harrow Council -  
Audit Progress Update**

# Audit Progress

## Financial Statements - 2021/22 audit

As detailed in our Audit Strategy Memorandums dated 19 July 2022, we agreed a timetable with management for the audit that was intended to enable us to provide an Audit Completion Report to the Committee's November meeting with formal sign off subject to the resolution of the national infrastructure asset issue.

### Harrow Council

We have been completing our detailed audit procedures to meet the timetable agreed for our reporting. However, during the execution phase of the audit, we have encountered delays in our work on the audit of income and expenditure, primarily due to the changes in ledger system during the year which has required us to do additional work. We have experienced delays in obtaining evidence to support the valuation of property, plant and equipment and investment property and at the point of writing, still require further evidence. At this point, we will largely be pausing our work, to enable the Council to respond to our valuation queries. We will agree a timetable with officers for the completion of our remaining fieldwork when the requested evidence is available. Section 2 of the audit report provides details of these in the context of the significant and enhanced risk to which they relate.

In addition, as the Council is aware, there is a national issue in relation to accounting for infrastructure assets which has impacted on every local authority with material infrastructure balances. The statutory override, which sets out how councils should respond to this accounting issue is currently out for consultation. Once the detail is available, the Council will need to consider the implications for its accounting treatment and any associated amendments to the accounts.

### Harrow Council Pension Fund

To date we have substantially completed the audit procedures on the data supporting the draft financial statements. Due to the nature of the two separate sets of accounts and the requirement to complete the principal authority audit prior to the pension fund, we will only be able to complete the formal sign off and closure of the audit at the same time as the completion of the London Borough of Harrow audit.

As a result of these delays, which arise from both the need to complete work on new significant risks arising in 2021/22 as well as additional work around existing significant risks, there will be a delay in completion of the audit. We are endeavouring to complete the audits as soon as possible.

# Audit Progress

## 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 be unable to conclude on the Council's value for money arrangements for the 2020/21 financial period until the Police investigation is complete.

### Auditor VFM responsibilities - 2021/22

We have completed our initial risk assessment of the Council's Value for Money arrangements and, at this stage, have no additional issues that we need to bring to the attention of the Committee.

Our work reviewing the value for money arrangements will continue throughout the course of the audit, and we will discuss the timing of our reporting with management in due course in light of the above.

# 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><b>Management override of controls</b></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>We are well progressed with our planned audit procedures and currently have no issues to bring to the Committee’s attention.</p>
2	<p><b>Risk of fraud in revenue recognition</b></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 are well progressed with our planned audit procedures and currently have no issues to bring to the Committee’s attention.</p>

# Audit Progress

## 2021/22 Audit – Progress on Significant Risks

	Description	Progress to date
3	<p><b>Valuation of net defined benefit pension liability</b></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>We are well progressed with our planned audit procedures. Our work to date has identified one immaterial amendment to the accounts.</p>
4	<p><b>Migration from SAP to D365</b></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 data 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>We are well progressed with our planned work. As part of these procedures, we identified that the Council no longer has access to legacy SAP servers, on which historic accounting records would have been maintained. The historic data having been extracted is now being held within a cloud based storage solution.</p> <p>The Council are providing us with details of their internal assurance procedures and work performed on the move to a cloud based system, that enabled them to conclude they have kept proper accounting records. We will review and consider this as part of our response to this significant risk and our consideration of the Council's compliance with laws and regulations.</p>

# Audit Progress

## 2021/22 Audit – Progress on Significant Risks

	Description	Progress to date
5	<p><b>Property, plant and equipment valuations</b></p> <p>Where a Council's assets are subject to revaluation, the Code requires that the carrying value should reflect the appropriate fair value as at the year end. Estimation of fair values is subject to complex estimation. This creates a risk that the carrying value of those assets revalued in the year are materially mis-stated.</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>Completion of our initial procedures identified a number of challenges to the methodologies that have been applied by the Council's valuer in valuing assets at 31 March 2022. With the assistance of our internal valuations team we are liaising with the Council's valuers to discuss the issues arising.</p> <p>Should this challenge result in the Council making amendments to valuations within the financial statements, we will perform detailed testing of the valuations in line with the initial planned responses to the property valuation risk.</p>
6	<p><b>Valuation of intangible assets</b></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.</p> <p>The council have recently completed this exercise, we will review the Council's proposed adjustments to the financial statements and reperform testing as appropriate.</p>

# 03

Section 03:

**London Borough of Harrow Council –  
Progress on Enhanced risks**

# Audit Progress

## 2021/22 Audit – Progress on Enhanced Risks

An enhanced risk is an area of higher assessed risk of material misstatement at audit assertion level other than a significant risk. Enhanced risks require additional consideration but does not rise to the level of a significant risk. Risk 1 was identified and reported to the Committee in the Audit Strategy Memorandum dated 19 July 2022. Our risk assessment process is continuous, and risk 2 was identified and communicated in our Audit Progress Report dated September 2022.

	Description	Progress to date
1	<p><b>Civic centre accounting treatment</b></p> <p>The Council are relocating to a new site, being the Harrow Civic Hub. As part of this move, the existing Civic Centre will be decommissioned and the land redeveloped, through a joint venture. The accounting treatment of the property transactions are likely to be complex and will require considerable technical input in order to achieve an appropriate valuation of the land and buildings and to ensure all required disclosures are made in the financial statements.</p> <p>Given the level of complexity, there is a risk management fail to meet the disclosure requirements for such an asset.</p>	<p>To date, we are yet to complete our planned audit procedures for this risk. As noted, our wider testing of valuation methodologies has resulted in a number of challenges to the Council, which are still being assessed. We have therefore paused our work until these have been considered and addressed by the Council at which point we will complete the planned audit procedures.</p>
2	<p><b>Valuation of inventory</b></p> <p>Within the 2021/22 financial statements, the Council has included a new material value in respect of inventory (£13m). This value relates to the Council's property developments at Waxwell Lane and Haslam House and reflects the value of expenditure on the two developments, with the work at each site still ongoing.</p> <p>Given the balance represents the implementation of new accounting treatment, and the level of management judgement involved in arriving at an appropriate valuation for such treatment, we consider there to be an enhanced audit risk.</p>	<p>We are well progressed with our planned audit procedures.</p> <p>Accounting for inventories within local government is highly complex where it relates to capital transactions. We have continued to review and discuss the Council's accounting treatment paper to confirm it meets with the Code requirements and, following the provision of further information by the Council, are awaiting additional commentary from our technical team.</p> <p>We will continue to discuss this material matter with the Council.</p>

# 04

## Section 04: **National Publications**

# National publications

	Publication/update	Key points
<b>Chartered Institute of Public Finance and Accountability (CIPFA)</b>		
1	CIPFA: Audit Committees Practical Guidance for local authorities and police	Guidance and resources for audit committee members.
<b>Department for Levelling Up, Housing and Communities</b>		
2	Consultation on Infrastructure Asset Accounting	The Government is consulting on a proposed temporary Statutory Override to unlock the difficulty in agreeing an accounting solution to this matter.
<b>National Audit Office (NAO)</b>		
3	Guide to Corporate Finance in the Public Sector	The guide uses insights from NAO stakeholder engagement and draws on NAO experience of auditing government interventions and corporate finance activities
<b>Financial Reporting Council (FRC)</b>		
4	Major Local Audits – Audit Quality Inspection	The Financial Reporting Council has published its annual report on the quality of local audit work. This follows its 2022 inspections of files for the 20/21 audit cycle.

# NATIONAL PUBLICATIONS

## 1. CIPFA: Audit Committees Practical Guidance for local authorities and police – October 2022

The guidance and suite of publications (only available for those with a subscription) has separate guidance resources for audit committee members in authorities, members of police audit committees, and a supplement for those responsible for guiding the committee. New aspects include legislation changes in Wales and new expectations in England following the Redmond Review.

The link to the publication is here: <https://www.cipfa.org/policy-and-guidance/publications/a/audit-committees-practical-guidance-for-local-authorities-and-police2022-edition>

## 2. Consultation on Infrastructure Asset Accounting – October 2022

CIPFA and CIPFA LASAAC have been seeking to assist in the resolution of this issue through changes to the Code of Practice on Local Authority Accounting (the Code). An accounting solution has not so far been found that satisfies all stakeholders for the amount to be derecognised. The government, therefore, undertook to review the necessity for an accounting statutory override whereby, under the Local Government Act 2003, it may make provision for local authority accounting practices.

The government is proposing to put in place a statutory accounting override to allow local authorities to treat the value of any replaced component of infrastructure assets as nil, without the need to further evidence that this is the case. The override also removes the requirement for authorities to make prior period adjustments to infrastructure asset balances. The override will not include any provision for matters relating to gross cost or accumulated depreciation, as these matters are anticipated to be addressed through the Code. Use of the override is expected to be optional, and authorities may choose not to apply it.

It is the government's view that this is a necessary, short-term solution to avoid the widespread qualification of local authority accounts. The government recognises that a long-term solution is required, but due to the complexity of the issue this will necessarily take time, and there is an immediate need to mitigate the risks of widespread qualifications and delays to audit. The proposed override applies to all local authority accounts for which an audit certificate has not been issued, and is time limited such that the last financial year to which it applies will be 2024/25. The government is conducting this call for evidence to seek views from sector stakeholders on the effectiveness and clarity of the proposed statutory override.

The consultation includes a draft Statutory Instrument and Explanatory Memorandum. The indicative date when this Statutory Instrument could take effect is 25 December 2022, so it is unlikely that auditors will be able to issue any audit opinions on clients with material infrastructure assets until January 2023.

[The Local Authorities \(Capital Finance and Accounting\) \(England\) \(Amendment\) Regulations 2022: call for evidence - Department for Levelling Up, Housing and Communities - Citizen Space](#)

# NATIONAL PUBLICATIONS

## 3. Guide to Corporate Finance in the Public Sector

The NAO recently published a guide to corporate finance in the public sector. The guide uses insights from NAO stakeholder engagement and draws on NAO experience of auditing government interventions and corporate finance activities. It covers 14 themes over three core areas:

- Principles and concepts
- Organisations and functions
- Transactions

The interactive guide contains insights from 139 NAO reports and sets out key questions for senior decision-makers to consider when overseeing corporate finance activities. It may also be of interest to professionals supporting the government to deliver a range of transactions, including commercial investments, loans and guarantees. While not directly focussed on local public services the guide may be of interest to local auditors and audited bodies.

<https://www.nao.org.uk/insights/guide-to-corporate-finance-in-the-public-sector/>

## 4. Major Local Audits – Audit Quality Inspection

The Financial Reporting Council (FRC) has published its annual report on the quality of local audit work. This follows its 2022 inspections of files for the 20/21 audit cycle. The headlines from the FRC report are that:

- The number of audits categorised as good or limited improvements required has remained consistent with the prior year. FRC assessed 70% of financial statements audits as requiring no more than limited improvements, the same as in the previous year. This is an improvement on the 46% average over the preceding three years. However, FRC identified the increased number of audits assessed as requiring significant improvements (15% in 2021/22 and none in 2020/21) as unacceptable and states that inconsistency is preventing firms from eradicating poor quality audits.
- Based on their inspections, FRC state that the quality of auditors' work on VFM arrangements remains high at all but one firm. Of the work inspected, 93% was categorised as good or limited improvements required (100% in the previous two years).

The FRC is concerned at the timeliness of reporting in the sector and raises this as a priority improvement area for audited bodies and auditors.

<https://www.frc.org.uk/getattachment/aeb9149f-7bf9-45f2-802d-ca7b055b457e/Major-Local-Audits.pdf>

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