

Lancashire County Council Audit Progress Report and Sector Update

Year ending 31 March 2021

5 July 2021



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The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit planning process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Authority or all weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

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Introduction

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This paper provides the Audit, Risk and Governance Committee with a report on progress in delivering our responsibilities as your external auditors.

The paper also includes:

- a summary of emerging national issues and developments that may be relevant to you as a local authority; and
- includes a number of challenge questions in respect of these emerging issues which the Committee may wish to consider (these are a tool to use, if helpful, rather than formal questions requiring responses for audit purposes)

Members of the Audit, Risk and Governance Committee can find further useful material on our website, where we have a section dedicated to our work in the public sector. Here you can download copies of our publications www.grantthornton.co.uk.

If you would like further information on any items in this briefing, or would like to register with Grant Thornton to receive regular email updates on issues that are of interest to you, please contact either your Engagement Lead or Engagement Manager.

Progress at 5 July 2021

Financial Statements Audit

We undertook our initial planning for the 2020/21 audit and the interim audit in March-April 2021. We expect to begin our initial work on your draft financial statements in July with the full team “on-site” in late August.

Our interim fieldwork includes:

- Updated review of the Authority’s control environment
- Updated understanding of financial systems
- Review of Internal Audit reports on core financial systems
- Understanding how the Authority makes material estimates for the financial statements
- Early work on emerging accounting issues

The results of our work to date are included in this report.

In April we issued a detailed audit plan, setting out our proposed approach to the audit of the Authority's 2020/21 financial statements.

We will report our work in the Audit Findings Report at the October Audit, Risk & Governance Committee. We expect to sign our audit opinion in November 2021.

Value for Money

The new Code of Audit Practice (the “Code”) came into force on 1 April 2020 for audit years 2020/21 and onwards. The most significant change under the new Code is the introduction of an Auditor’s Annual Report, containing a commentary on arrangements to secure value for money and any associated recommendations, if required.

There are three main changes arising from the NAO’s new approach:

- A new set of key criteria, covering financial sustainability, governance and improvements in economy, efficiency and effectiveness
- More extensive reporting, with a requirement on the auditor to produce a commentary on arrangements across all of the key criteria, rather than the current ‘reporting by exception’ approach
- The replacement of the binary approach to VFM conclusions, with far more sophisticated judgements on performance, as well as key recommendations on any significant weaknesses in arrangements identified during the audit.

The NAO have updated AGN 03 to reflect the exceptional circumstances arising due to the impact of Covid-19. In summary, auditors are being given greater flexibility in the timing and completion of their VFM work. The revised AGN03 clarifies how auditors can give an opinion if they haven’t yet completed all their VFM work. It also introduces revised deadlines for the issuing of the Auditor’s Annual Report.

For LG bodies, the deadline will be 3 months from the date of the opinion.

The NAO have confirmed that any significant weaknesses the auditor has identified and reported up to the point of issuing their opinion should still be reported by exception in their opinion. Where the auditor still needs to carry out work to determine whether or not there are significant weaknesses in value for money arrangements, they should not certify completion until all of their planned work is complete.

Audit Deliverables

2020/21 Deliverables	Planned Date	Status
Audit Plan We are required to issue a detailed audit plan to the Audit, Risk and Governance Committee setting out our proposed approach in order to give an opinion on the Authority's 2020/21 financial statements and the Auditor's Annual Report on the Authority's Value for Money arrangements.	April 2021	Complete
Interim Audit Findings We will report to you the findings from our interim audit and our initial value for money risk assessment within our Progress Report.	July 2021	Complete
Audit Findings Report The Audit Findings Report will be reported to the October Audit, Risk and Governance Committee.	October 2021	Not yet due
Auditors Report This is the opinion on your financial statements.	November 2021	Not yet due
Auditor's Annual Report This Report communicates the key issues arising from our Value for Money work.	Within three months of the opinion on the financial statements	Not yet due

Results of Interim Audit Work

The findings of our interim audit work, and the impact of our findings on the accounts audit approach, are summarised in the table below:

	Work performed	Conclusions and recommendations
Internal audit	We have also reviewed internal audit's work on the Authority's key financial systems to date. We have not identified any significant weaknesses impacting on our responsibilities.	Our review of internal audit work has not identified any weaknesses which impact on our audit approach.
Entity level controls	<p>We have obtained an understanding of the overall control environment relevant to the preparation of the financial statements including:</p> <ul style="list-style-type: none"> • Communication and enforcement of integrity and ethical values • Commitment to competence • Participation by those charged with governance • Management's philosophy and operating style • Organisational structure • Assignment of authority and responsibility • Human resource policies and practices 	Our work has identified no material weaknesses which are likely to adversely impact on the Authority's financial statements.
Review of information technology controls	<p>Our information systems specialist are performing a high level review of the general IT control environment, as part of the overall review of the internal controls system.</p> <p>IT (information technology) controls will be observed to determine if they have been implemented appropriately.</p>	Our work has not yet been finalised. Our IT specialists are currently liaising with officers at the Authority to arrange further meetings.

	Work performed	Conclusions and recommendations
Walkthrough testing	<p>We have completed walkthrough tests of the Authority's controls operating in areas where we consider that there is a significant risk of material misstatement to the financial statements – Valuation of Land and Buildings and the Valuation of Net Pension Liabilities.</p> <p>Our work has not identified any issues which we wish to bring to your attention. Internal controls have been implemented by the Authority in accordance with our documented understanding.</p>	<p>Our work has not identified any weaknesses which impact on our audit approach.</p>
Journal entry controls	<p>We have reviewed the Authority's journal entry policies and procedures as part of determining our journal entry testing strategy and have not identified any material weaknesses which are likely to adversely impact on the Authority's control environment or financial statements.</p>	<p>Our work has not identified any weaknesses which impact on our audit approach. We will undertake further testing of journals during our final accounts visit.</p>
Assurance Letters from management and those charged with governance	<p>As part of our planning work to understand the Trust's governance arrangements, we have raised a number of questions to management which are to be reviewed and approved by Those Charged With Governance. The questions deal with a variety of issues such as internal control, risk management, fraud and litigation, and the potential impact of these areas on the Trust annual accounts. There are also additional questions regarding accounting estimates as a result of the amendments to ISA 540 (Accounting Estimates) for 2020-21.</p>	<p>Management provided responses to all of our questions and they were presented to the April 2021 Audit, Risk and Governance Committee where they were reviewed and approved by Those Charged With Governance.</p>

Sector Update

Authorities continue to try to achieve greater efficiency in the delivery of public services, whilst facing the challenges to address rising demand, ongoing budget pressures and social inequality.

Our sector update provides you with an up to date summary of emerging national issues and developments to support you. We cover areas which may have an impact on your organisation, the wider local government sector and the public sector as a whole. Links are provided to the detailed report/briefing to allow you to delve further and find out more.

Our public sector team at Grant Thornton also undertake research on service and technical issues. We will bring you the latest research publications in this update. We also include areas of potential interest to start conversations within the organisation and with audit committee members, as well as any accounting and regulatory updates.

- [Grant Thornton Publications](#)
- [Insights from local government sector specialists](#)
- [Reports of interest](#)
- [Accounting and regulatory updates](#)

More information can be found on our dedicated public sector and local government sections on the Grant Thornton website by clicking on the logos below:

A teal rectangular button with the text "Public Sector" in white, sans-serif font, centered within the button.

Public Sector

A dark purple rectangular button with the text "Local government" in white, sans-serif font, centered within the button.

Local
government

Revised auditing standard: Auditing Accounting Estimates and Related Disclosures

In the period December 2018 to January 2020 the Financial Reporting Council issued a number of updated International Auditing Standards (ISAs (UK)) which are effective for audits of financial statements for periods beginning on or after 15 December 2019. ISA (UK) 540 (revised): *Auditing Accounting Estimates and Related Disclosures* includes significant enhancements in respect of the audit risk assessment process for accounting estimates.

Introduction

Under ISA (UK) 540 (Revised December 2018) auditors are required to understand and assess an entity's internal controls over accounting estimates, including:

- The nature and extent of oversight and governance over management's financial reporting process relevant to accounting estimates;
- How management identifies the need for and applies specialised skills or knowledge related to accounting estimates;
- How the entity's risk management process identifies and addresses risks relating to accounting estimates;
- The entity's information system as it relates to accounting estimates;
- The entity's control activities in relation to accounting estimates; and
- How management reviews the outcomes of previous accounting estimates.

As part of this process auditors also need to obtain an understanding of the role of those charged with governance, which is particularly important where the estimates have high estimation uncertainty, or require significant judgement.

Specifically do Audit, Risk & Governance Committee members:

- Understand the characteristics of the methods and models used to make the accounting estimates and the risks related to them;
- Oversee management's process for making accounting estimates, including the use of models, and the monitoring activities undertaken by management; and
- Evaluate how management made the accounting estimates?

Additional information that will be required for our March 2021 audits

To ensure our compliance with this revised auditing standard, we will be requesting further information from management and those charged with governance during our audit for the year ended 31 March 2021 in all areas summarised above for all material accounting estimates that are included in the financial statements.

Based on our knowledge of the Authority we have identified the following material accounting estimates for which this is likely to apply:

- Valuations of land and buildings and investment properties
- Depreciation
- Year end provisions and accruals
- Credit loss and impairment allowances
- Valuation of defined benefit net pension fund liabilities
- Fair value estimates
- Valuation of level 2 and level 3 financial instruments

The Authority's Information systems

In respect of the Authority's information systems we are required to consider how management identifies the methods, assumptions and source data used for each material accounting estimate and the need for any changes to these. This includes how management selects, or designs, the methods, assumptions and data to be used and applies the methods used in the valuations.

When the models used include increased complexity or subjectivity, as is the case for many valuation models, auditors need to understand and assess the controls in place over the models and the data included therein. Where adequate controls are not in place we may need to report this as a significant control deficiency and this could affect the amount of detailed substantive testing required during the audit.

If management has changed the method for making an accounting estimate we will need to fully understand management's rationale for this change. Any unexpected changes are likely to raise the audit risk profile of this accounting estimate and may result in the need for additional audit procedures.

We are aware that the Authority uses management experts in deriving some of its more complex estimates, e.g. asset valuations and pensions liabilities. However, it is important to note that the use of management experts does not diminish the responsibilities of management and those charged with governance to ensure that:

- All accounting estimates and related disclosures included in the financial statements have been prepared in accordance with the requirements of the financial reporting framework, and are materially accurate;
- There are adequate controls in place at the Authority (and where applicable its service provider or management expert) over the models, assumptions and source data used in the preparation of accounting estimates.

Estimation uncertainty

Under ISA (UK) 540 (Revised December 2018) we are required to consider the following:

- How management understands the degree of estimation uncertainty related to each accounting estimate; and
- How management addresses this estimation uncertainty when selecting their point estimate.

For example, how management identified and considered alternative methods, assumptions or source data that would be equally valid under the financial reporting framework, and why these alternatives were rejected in favour of the point estimate used.

The revised standard includes increased emphasis on the importance of the financial statement disclosures. Under ISA (UK) 540 (Revised December 2018), auditors are required to assess whether both the accounting estimates themselves and the related disclosures are reasonable.

Where there is a material uncertainty, that is where there is a significant risk of a material change to the estimated carrying value of an asset or liability within the next year, there needs to be additional disclosures. Note that not all material estimates will have a material uncertainty and it is also possible that an estimate that is not material could have a risk of material uncertainty.

Where there is material estimation uncertainty, we would expect the financial statement disclosures to include:

- What the assumptions and uncertainties are;
- How sensitive the assets and liabilities are to those assumptions, and why;
- The expected resolution of the uncertainty and the range of reasonably possible outcomes for the next financial year; and
- An explanation of any changes made to past assumptions if the uncertainty is unresolved.

Further information

Further details on the requirements of ISA (UK) 540 (Revised December 2018) can be found in the auditing standard on the Financial Reporting Council's website:

[https://www.frc.org.uk/getattachment/0fa69c03-49ec-49ae-a8c9-cc7a2b65382a/ISA-\(UK\)-540_Revised-December-2018_final.pdf](https://www.frc.org.uk/getattachment/0fa69c03-49ec-49ae-a8c9-cc7a2b65382a/ISA-(UK)-540_Revised-December-2018_final.pdf)

Insight into accounting for grants in local government financial statements – Grant Thornton

The government has provided a range of financial support packages throughout the COVID-19 pandemic.

We have issued a brief bulletin aimed at helping local government bodies identify the key things they should consider when determining the accounting treatment for these grants in their financial statements for 2020/21.

There are no changes to the accounting treatment for grants as required by the CIPFA Code of Practice on Local Authority Accounting. What has changed, is the extent of additional funding to support the cost of services, to offset other income losses along with grant packages to be paid out to support local business. Local authorities need to consider the nature and terms of the various COVID-19 measures in order to determine whether there is income and expenditure to be recognised in the Comprehensive Income and Expenditure Statement in 2020/21.

The report highlights the factors to consider, including:

- Where the funding is to be transferred to other parties, is the authority acting as principal or as agent?
- Are there grant conditions outstanding?
- Is the grant a specific or non-specific grant?

Our bulletin provides you with links to further information on the various support packages and summarises features that may be relevant to your judgements as you determine the appropriate accounting treatment.

Local authorities need to demonstrate their judgements on the accounting treatment to be reasonable and soundly based and, where these have a significant effect on the accounts, to ensure they include sufficient disclosures to meet the requirements of IAS 1:122.

Please ask your audit manager for the full report:



Local government finance in the pandemic – National Audit Office

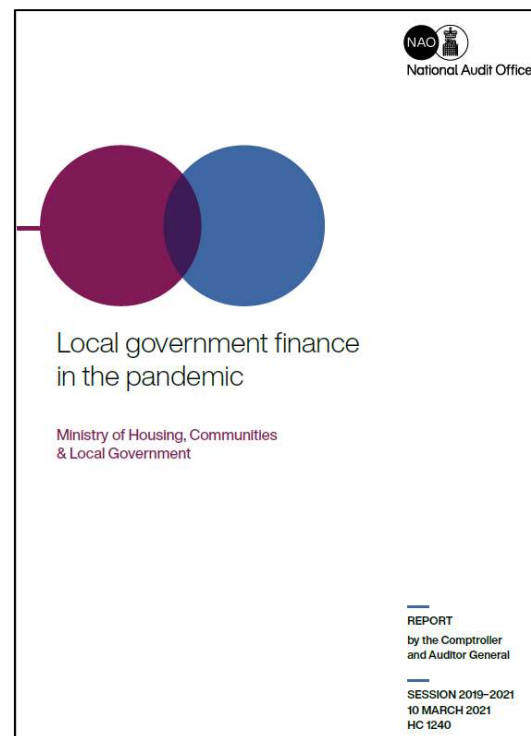
The National Audit Office (NAO) report, published in March, notes “The COVID-19 pandemic has been an unprecedented public health and economic emergency. Local authorities in England have made a major contribution to the national response to the pandemic, working to protect local communities and businesses, while continuing to deliver existing services. The pandemic has in turn placed significant pressure on local authorities’ finances, which in many cases were already under strain going into the pandemic.”

The NAO report examines if the Department’s approach to local government finance in the COVID-19 pandemic enabled it to assess and fund the costs of new services which local authorities have been asked to deliver. It also examines whether the Department fulfilled its responsibilities in securing financial sustainability across the sector.

The NAO report concludes “Steps taken by the government, led by the Department, have supported local authorities in the COVID-19 pandemic response. The Department’s successful monthly collection of data and continued intensive engagement with the sector provided a good evidence base to underpin the financial and other support provided by government. Action by the Department and wider government to support the sector has averted system-wide financial failure at a very challenging time and means that the Department has managed the most severe risks to value for money in the short term.

However, the financial position of local government remains a cause for concern. Many authorities will be relying on reserves to balance their 2020-21 year-end budgets. Despite continuing support into 2021-22 the outlook for next year is uncertain. Many authorities are setting budgets for 2021-22 in which they have limited confidence, and which are balanced through cuts to service budgets and the use of reserves.”

The NAO report found that “the combined impact on spending and non-tax income in 2020-21 is £9.7bn – equivalent to 17.6% of revenue expenditure. So far the government has announced £9.1bn of financial support, leaving a deficit of £605m.”



The full report can be obtained from the NAO website:

[Local government finance in the pandemic - National Audit Office \(NAO\) Report](#)

Initial learning from the government's response to the COVID-19 pandemic

The National Audit Office (NAO) report, published in May, notes “The scale and nature of the COVID-19 pandemic and the government’s response are without precedent in recent history. The pandemic continues to be a major challenge for government, public sector bodies, as well as people across the UK and worldwide. Many people have died, and many lives have been adversely affected. The overall long-term impact and cost of the pandemic remains uncertain but will be substantial”.

Background to report

The COVID-19 pandemic has stress-tested the government’s ability to deal with unforeseen events and potential shocks. Government has often acted at unprecedented speed to respond to a virus which has caused dramatic disruption to people’s lives, public service provision and society as a whole. Government had to continue to deliver essential public services, while reprioritising resources to deliver its response to the COVID-19 pandemic and supporting staff to work from home. In its response, government has had to streamline decision-making, work across departments and public bodies and use a range of delivery structures.

Departments will need to reflect on the lessons learned to ensure that they capitalise on the benefits and opportunities these new ways of working have brought.

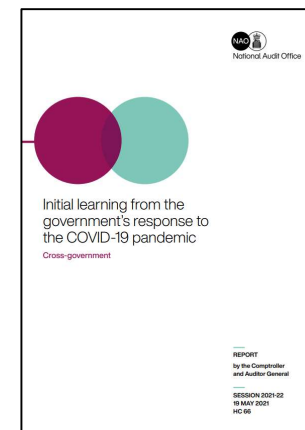
Scope of the report

The report draws out learning from the reports that we have published to date, as well as other work they have published that covered the COVID-19 pandemic.

It sets out this learning across six themes:

- risk management;
- transparency and public trust;
- data and evidence;
- coordination and delivery models;
- supporting and protecting people; and
- financial and workforce pressures.

The NAO will continue to draw out learning from the government’s response to the pandemic in their future work.



The full report can be obtained from the NAO website:

[Initial learning from the government's response to the COVID-19 pandemic - National Audit Office \(NAO\) Report](#)



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