Annex 1

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# Audit Progress Report and Sector Update

## Lancashire County Council

Year ending 31 March 2021

8 January 2021

# Contents

# Introduction

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## This paper provides the Audit, Risk & 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.

Members of the Audit, Risk & 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 Paul or Stuart.

# Financial Statements Audit 2019/20 Update

## Financial Statements Audit

We were unable to issue our signed audit opinion on the Council's 2019-20 financial statements in advance of the national deadline of 30 November 2020.

This is due to us requiring assurance over the classification and valuation of Lender-Option Buyer-Option (LOBO) related investments held by the Council as at 31/3/20. These investments had changed classification in 19-20 to being held at Fair Value through profit and loss (FVTPL). The classification in 18-19 was amortised cost. Whilst we were able to gain our required assurance over the classification of the investments before the 30/11/20 deadline our assurance over the valuation is still outstanding.

At the time of writing this report, we are currently awaiting the results from our internal valuations team to assist us with gaining our assurance over the valuation of the LOBO investments as this will inform the need of whether a prior period adjustment is required. The key element we require assistance over is with regards to the valuation of the options embedded within the investments and that the approach adopted by the Council is reasonable. We have already consulted with an external valuation expert but have decided to also seek the view of our own in house valuations team. We expect to have results back from our valuations team during January.

With regards to the classification of the investments, there are very few circumstances permitted for reclassification under IFRS 9 and, following our challenge to the Council over the classification, the Council agreed that the criteria for reclassification was not met. However, the Council reviewed the classification of amortised cost in 2018/19 and determined that this was the incorrect classification. These assets have always been intended to be held for trading and the intention has been to sell them from soon after they were acquired. Management have provided us with correspondence which demonstrates this position as well as justification for these assets meeting the required business model for classification as FVTPL under IFRS 9.

We anticipate that we will be in a position to issue our opinion by the end of January. Our anticipated audit report opinion will be unqualified but with an Emphasis of Matter paragraph in relation to material uncertainties with regards to the valuation of PPE and the estimated share of the Pension Fund property assets.

Our updated Audit Findings Report attached in the committee papers has further information.

## Value for Money opinion

We anticipate we will issue an unqualified value for money opinion for the year ended 31 March 2020. This opinion will be issued along with the financial statements opinion once the work is finalised.

The NAO consultation on a new Code of Audit Practice (the "Code") has finished, and the new Code has completed its approval process in Parliament. It therefore came into force on 1 April 2020 for audit years 2020/21 and onwards. The new Code supersedes the Code of Audit Practice 2015, which was published by the National Audit Office (NAO) in April 2015.

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. The NAO public consultation ran until 2 September 2020. The NAO will now analyse all consultation responses received and consider what changes are required to the draft guidance. Please see page 8 for more details.

## Lancashire County Pension Fund Financial statements and Annual Report

We anticipate that we will issue an unqualified opinion on the Lancashire County Pension Fund financial statements but with an Emphasis of Matter paragraph in relation to material uncertainties with regards to the valuation of Property investment assets and that we will also issue positive assurance that the Pension Fund's Annual Report is consistent with the financial statement.

We are unable to issue these opinions until we are ready to issue our opinion on the Council's financial statements.

## Certification of the Audit

We are unable to certify the closure of the 2019/20 audit of Lancashire County Council until we have completed our consideration of matters brought to our attention by the Council in 2013. We are continuing to monitor developments with the ongoing Police investigation. Once the Police investigation is concluded, and we have had an opportunity to consider the outcome, we will assess the implications for our audit of the Council.

## Other areas

### Certification of claims and returns

**Teachers Pension's End of Year Contributions (EOYC) Return 2019-20** – We have completed our certification of the Council's Teachers Pension's EOYC return. We issued our independent accountant's report to the Council and to Teachers' Pensions on 18 November 2020, ahead of the 30 November 2020 deadline.

### Meetings

We meet with Finance Officers on a regular basis, including the Director of Finance and Deputy Director of Finance, who we last met in December 2020. In October we also met with the Council's Chief Executive.

### Events

We provide a range of workshops, along with network events for members and publications to support the Council. Your officers have/will be invited to attend our Financial Reporting Workshop in February, which aims to help ensure that members of your Finance Team are up to date with the latest financial reporting requirements for local authority accounts.

Further details of the publications that may be of interest to the Council are set out in our Sector Update section of this report.

## Audit Fees

Our Audit Fee for the 2019-20 audit was confirmed by the Audit, Risk & Governance Committee on 27 July 2020.

Over the past six months the current Covid-19 pandemic has had a significant impact on all of our lives, both at work and at home. The impact of Covid-19 on the audit of the financial statements for 2019/20 has been multifaceted. This includes:

- Revisiting planning - we have needed to revisit our planning and refresh risk assessments, materiality and testing levels. This has resulted in the identification of a significant risk at the financial statements level in respect of Covid-19 necessitating the issuing of an addendum to our original audit plan as well as additional work on areas such as going concern and disclosures in accordance with IAS1 particularly in respect to material uncertainties.

- Management's assumptions and estimates - there is increased uncertainty over many estimates including investment valuations. We have include an Emphasis of Matter in the Audit Report in respect of the material uncertainty on property values.

- Remote working – the most significant impact in terms of delivery is the move to remote working. We, as other auditors, have experienced delays and inefficiencies as a result of remote working.. These are understandable and arise from the availability of the relevant information. In many instances the delays are caused by our inability to sit with an officer to discuss a query or working paper. Gaining an understanding via Teams or phone is more time-consuming.

We have been discussing this issue with Public Sector Audit Appointments (PSAA) over the last few months and note these issues are similar to those experienced in the commercial sector and NHS. In both sectors there has been a recognition that audits will take longer with commercial audit deadlines being extended by 4 months and NHS deadline by a month. The Financial Reporting Council (FRC) has also issued guidance to companies and auditors setting out its expectation that audit standards remain high and of additional work needed across all audits. The link attached https://www.frc.org.uk/covid-19-guidance-and-advice (see guidance for auditors) sets out the expectations of the FRC.

This amounts to £16,500 of additional audit fee for Lancashire County Council as a result of Covid-19. Additional fees to cover the impact of Covid 19 have been levied on all of our audits. Please note that these proposed additional fees are subject to approval by PSAA in line with the Terms of Appointment.

# Audit deliverables

| 2019/20 Deliverables | Planned Date | Status |
| --- | --- | --- |
| **Audit Findings Report**<br>The Audit Findings Report will be reported to the October Audit, Risk & Governance Committee. | **October 2020** | **October 2020**<br>**Final January 2021** |
| **Auditors Report**<br>This is the opinion on your Financial Statement, Annual Governance Statement and Value for Money conclusion. | **November 2020** | **Not yet issued** |
| **Annual Audit Letter**<br>This letter communicates the key issues arising from our work. | **January 2021** | **Not yet issued** |
| **2020/21 Deliverables** | | |
| **Fee Letter** | **April 2021** | **Not yet due** |
| **Audit Plan** | **April 2021** | **Not yet due** |
| **Interim Findings** | **April 2021** | **Not yet due** |
| **Audit Opinion** | **September 2021 (TBC)** | **Not yet due** |
| **Audit Annual Report** | **September 2021 (TBC)** | **Not yet due** |

# Sector update

Councils 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:

Public Sector

Local government

**https://www.grantthornton.co.uk/en/industries/public-sector**

# New NAO Code of Audit Practice for 2020-21

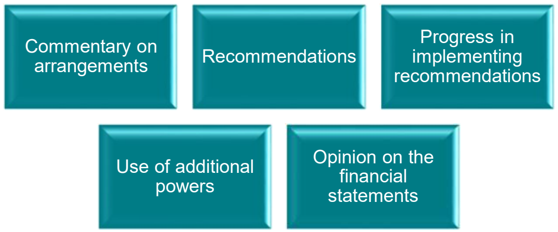
The NAO issued a new Code of Audit Practice which came into force on 1 April 2020 and applies to audits of 2020-21. The key change is an extension to the framework for VfM work. The NAO has prepared Auditor Guidance Note (AGN 03), which sets out detailed guidance on what VfM work needs to be performed. Public consultation on this ended 2 September.

The new approach to VfM re-focuses the work of local auditors to:

- promote more timely reporting of significant issues to local bodies;
- provide more meaningful and more accessible annual reporting on VfM arrangements issues in key areas;
- provide a sharper focus on reporting in the key areas of financial sustainability, governance, and improving economy, efficiency and effectiveness; and
- provide clearer recommendations to help local bodies improve their arrangements.

Under the previous Code, auditors had only to undertake work on VFM where there was a potential significant risk and reporting was by exception. Whereas against the new Code, auditors are required to undertake work to provide a commentary against three criteria set by the NAO – governance; financial sustainability and improving economy, efficiency and effectiveness.

A new Auditor's Annual Report presented at the same time as the audit opinion is the forum for reporting the outcome of the auditor's work on Value for Money. It is required to contain:




The '**Commentary on arrangements**' will include a summary under each of the three specified reporting criteria and compared to how the results of VfM work were reported in previous years, the commentary will allow auditors to better reflect local context and also to draw attention to emerging or developing issues which may not represent significant weaknesses, but which may nevertheless require attention from the body itself. The commentary will not simply be a description of the arrangements in place, but an evaluation of those arrangements.

**Recommendations**: Where an auditor concludes there is a significant weakness in a body's arrangements, they report this to the body and support it with a recommendation for improvement.

**Progress in implementing recommendations**: Where an auditor has reported significant weaknesses in arrangements in the previous year, the auditor should follow up recommendations issued previously and include their view as to whether the recommendations have been implemented satisfactorily

**Use of additional powers**: Where an auditor uses additional powers, such as making statutory recommendations or issuing a public interest report, this needs to be reported in the auditor's annual report.

**Opinion on the financial statements**: The auditor's annual report also needs to summarise the results of the auditor's work on the financial statements. This is not a replacement for the Audit Findings Report, or a verbatim repeat of it – it is simply a summary of what the opinion audit found

The new approach is more complex, more involved and will subsequently increase the cost of audit. We will be discussing this with the Director of Finance shortly.

To review the new Code and AGN03 see - https://www.nao.org.uk/code-audit-practice/code-of-audit-practice-consultation/

# Local government reorganisation in two-tier shire counties – County Councils' Network

The County Councils' Network (CCN) has published new independent evidence on the implications of local government reorganisation in two-tier shire counties ahead of the publication of the government's 'devolution and local recovery' white paper.

The report identifies considerations relating to:

- the costs associated with disaggregation;
- what this might mean in terms of risk and resilience of service provision;
- how service performance might be impacted;
- what it could mean for the place agenda; and
- issues arising from the response to Covid-19.

The report also sets out the financial implications of four unitary scenarios:

- Establishing one unitary authority in every two-tier area in England.
- Establishing two new unitary authorities in every two-tier area in England.
- Establishing three new unitary authorities in every two-tier area in England.
- Establishing two new unitary authorities and a children's trust in every two-tier area in England.

CCN note "With councils in shire counties facing billions in rising costs for care services, alongside financial deficits caused by the Coronavirus pandemic, the study from PricewaterhouseCoopers (PwC) shows merging district and county councils in each area into a single unitary council could save £2.94bn over five years nationally."

CCN go on to comment "The report concludes a single unitary in each area would reduce complexity and give communities a single unified voice to government. It would provide a clear point of contact for residents, businesses and a platform to 'maximise' the benefits of strategic economic growth and housing policy; integral to the 'levelling-up' agenda and securing devolution.

However, the report shows replacing county and districts with two unitary authorities in each area would reduce the financial benefit by two-thirds to £1bn over five years, with three unitary authorities delivering a net loss of £340m over the same period. A fourth scenario of a two-unitary and children's trust model in each county would deliver a net five year saving of £269m.

Alongside a minimum £1.9bn in additional costs from splitting county council services, the report outlines the establishment of multiple unitary authorities in each area creates the risk of disruption to the safeguarding of vulnerable children, while 'instability' in care markets could impact on the quality and availability of support packages and care home placements."


The full report can be obtained from the County Councils' Network website:

https://www.countycouncilsnetwork.org.uk/new-analysis-reveals-that-single-unitary-councils-could-deliver-3bn-saving-over-five-years-and-maximise-the-benefits-of-economic-growth-and-housing-policy/

# CIPFA – Financial Scrutiny Practice Guide

Produced by the Centre for Public Scrutiny (CfPS) and CIPFA, this guide provides guidance to councils and councillors in England on how they might best integrate an awareness of council finances into the way that overview and scrutiny works.

The impact of the COVID-19 pandemic on council finances, uncertainty regarding the delayed fair funding review and future operations for social care – on top of a decade of progressively more significant financial constraints – has placed local government in a hugely challenging position.

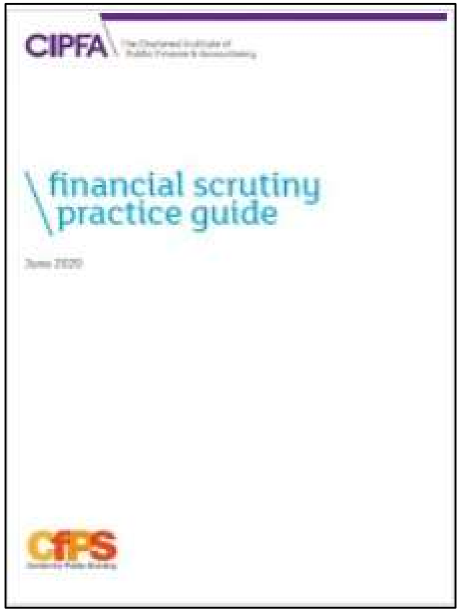
For the foreseeable future, council budgeting will be even more about the language of priorities and difficult choices than ever before.

This guide suggests ways to move budget and finance scrutiny beyond set-piece scrutiny ‘events’ in December and quarterly financial performance scorecards being reported to committee. Effective financial scrutiny is one of the few ways that councils can assure themselves that their budget is robust and sustainable, and that it intelligently takes into account the needs of residents.

Scrutiny can provide an independent perspective, drawing directly on the insights of local people, and can challenge assumptions and preconceptions. It can also provide a mechanism to ensure an understanding of tough choices that councils are now making.

This paper has been published as the local government sector is seeking to manage the unique set of financial circumstances arising from the COVID-19 pandemic. This has resulted, through the Coronavirus Act 2020 and other legislation, in changes to local authorities’ formal duties around financial systems and procedures.

The approaches set out in this guide reflect CfPS and CIPFA’s thinking on scrutiny’s role on financial matters as things stand, but the preparation for the 2021/22 budget might look different. CfPS has produced a separate guide to assist scrutineers in understanding financial matters during the pandemic




The full report can be obtained from CIPFA’s website:

[https://www.cipfa.org/policy-and-guidance/reports/financial-scrutiny-practice-guide](https://www.cipfa.org/policy-and-guidance/reports/financial-scrutiny-practice-guide)

# Value for Money update for Audit, Risk & Governance Committee on new arrangements for 2020-21

# How have the NAO changed value for money work ?

NAO National Audit Office

Code of Audit Practice

APRIL 2020

NAO National Audit Office

AGN 03
Auditors' Work on VFM Arrangements

Issued on xxxx

## Auditor Guidance Note 3 (AGN 03)

## Auditors' Work on Value for Money (VFM) Arrangements

**Version issued on: xxxx**



**About Auditor Guidance Notes**

Auditor Guidance Notes (AGNs) are prepared and published by the National Audit Office (NAO) on behalf of the Comptroller and Auditor General (C&AG) who has power to issue guidance to auditors under Schedule 6 paragraph 9 of the Local Audit and Accountability Act 2014 (the Act).

AGNs set out guidance to which local auditors must have regard under Section 20(6) of the Act. The guidance in AGNs supports auditors in meeting their requirements under the Act and the *Code of Audit Practice* published by the NAO on behalf of the C&AG.

The NAO also issues Weekly Auditor Communications (WACs) to local auditors to bring to their attention relevant information to support them in carrying out audit work. The firms that are local auditors under the Act may use WACs to update their own internal communications and reference tools.

AGNs are numbered sequentially and published on the NAO's website. Any new or revised AGNs are brought to the attention of local auditors through the WACs.

The NAO prepares Auditor Guidance Notes (AGNs) solely to provide guidance to local auditors in interpreting the Code of Audit Practice made under the Local Audit and Accountability Act 2014. The contents of AGNs cannot be reproduced, copied or re-published by parties other than local auditors without permission from the NAO.

The AGNs are designed to assist local auditors in forming their own understanding of the requirements of the Code. Auditors are required to have regard to AGNs, which means that they must take into account the guidance issued by the NAO, and, if they decide not to follow it, they must give clear (in the sense of objective, proper, and legitimate) reasons within audit documentation as to why they have not followed the guidance. AGNs are in no way intended as a substitute for the exercise of the independent professional skill and judgement of a local auditor in deciding how to apply the NAO's guidance or when providing explanations as to why guidance has not been followed.

Local auditors should not assume that AGNs are comprehensive or that they will provide a definitive answer in every case.

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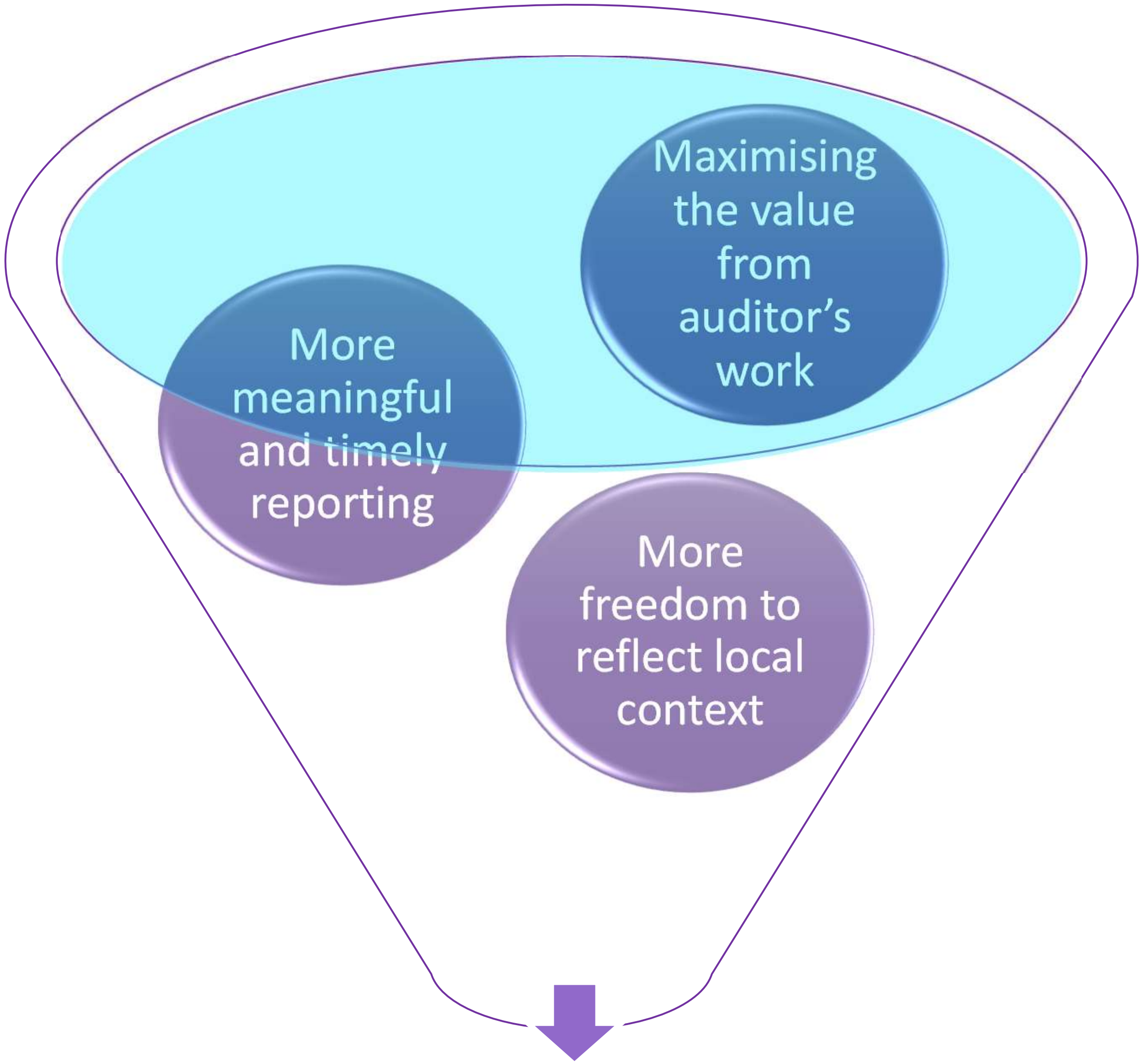
# How is value for money work changing ?




**VFM arrangements commentary and recommendations**

# The three criteria have changed…

| | |
|---|---|
| ~~Informed decision making~~ | Governance |
| ~~Sustainable resource deployment~~ | Financial sustainability |
| ~~Working with partners and other third parties~~ | Improving economy, efficiency and effectiveness |

# A key change in reporting…

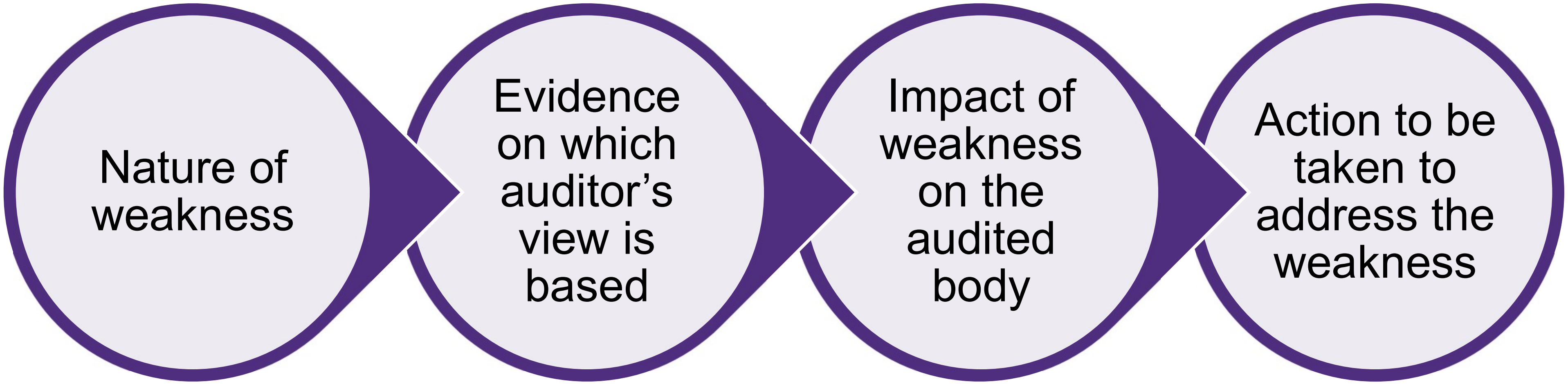

~~Annual Audit Letter~~

Auditor's Annual Report

# So what is in an Auditor's Annual Report ?

- Commentary on arrangements
- Recommendations
- Progress in implementing recommendations
- Use of additional powers
- Opinion on the financial statements

# Recommendations



# Practical implications

The new approach is more complex, more involved and will lead to better quality working achieving more impact. Before beginning work, we will discuss with you:

- Timing
- Resourcing

# 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 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 Council we have identified the following material accounting estimates for which this is likely to apply:

- Valuations of land and buildings,
- Depreciation
- Year end provisions and accruals
- Credit loss and impairment allowances
- Valuation of defined benefit net pension fund liabilities
- Fair value estimates
- Valuation of investments

**The Council's Information systems**

In respect of the Council'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 Council uses management experts in deriving some of its more complex estimates, e.g. investments and asset valuations. 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 Council (and where applicable its 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 address 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 disclose:
- 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 uncertainly is unresolved.

**How can you help**

As part of our planning risk assessment procedures we routinely make a number of enquiries of management and those charged with governance, which include general enquiries, fraud risk assessment questions, going concern considerations etc. Responses to these enquires are completed by management and confirmed by those charged with governance at an Audit Committee meeting. For our 2020/21 audit we will be making additional enquires on your accounting estimates in a similar way (which will cover the areas highlighted above).

**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

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