

Audit Progress Report and Sector Update

Lancashire Combined Fire Authority
Year ending 31 March 2020

March 2021



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Introduction



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This paper provides the Audit 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 fire 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)



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Members of the Audit 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 March 2021

2020/21

We will now begin to look to the 2020/21 financial year and begin our planning processes for the audit.

Our formal work will begin in late March and early April and in the meantime we will:

- have regular discussions with management to inform our risk assessment for the 2020/21 financial and value for money audits
- review board papers and latest financial and operational performance reports
- consider any reports from regulators regarding your clinical / operational effectiveness.

We expect to issue our audit plan summarising our approach to key risks on the audit at the next Audit Committee.

Value for Money

On 1 April 2020, the National Audit Office introduced a new Code of Audit Practice which comes into effect from audit year 2020/21. The Code introduced a revised approach to the audit of Value for Money. (VFM)

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 (qualified / unqualified) 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.

Further detail on the NAO's revised approach to VFM work can be found here: <https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2019/12/AGN-03-Auditors-Work-on-Value-for-Money-Arrangements.pdf>

Due to the change in approach, a fee variation will be needed for 2020-21 and your Engagement Team should be in touch shortly to discuss this.

The new Code of Audit Practice issued by the NAO can be found here: https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2020/01/Code_of_audit_practice_2020.pdf

Other areas

Meetings

We met with Finance Officers in March as part of our regular liaison meetings and continue to be in discussions with finance staff regarding emerging developments and to ensure the audit process is smooth and effective.

Events

We provide a range of workshops, along with network events for members and publications to support the Authority. Your officers attended our Financial Reporting Workshop in February, which helped to ensure that members of your Finance Team were 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 Authority are set out in our Sector Update section of this report.

Audit Deliverables

2020/21 Deliverables	Planned Date	Status
<p>Fee Letter</p> <p>Confirming audit fee for 2020/21.</p>	April 2020	Complete
<p>Audit Plan</p> <p>We are required to issue a detailed audit plan to the Audit Committee setting out our proposed approach in order to give an opinion on the Authority's 2019-20 financial statements and a Conclusion on the Authority's Value for Money arrangements.</p>	July 2021	Not yet due
<p>Interim Audit Findings</p> <p>We will report to you the findings from our interim audit and our initial value for money risk assessment within our Progress Report.</p>	July 2021	Not yet due
<p>Audit Findings Report</p> <p>The Audit Findings Report will be reported to the September Audit Committee ahead of the 30th September national deadline.</p>	September 2021	Not yet due
<p>Auditors Report</p> <p>This is the opinion on your financial statement, annual governance statement and value for money conclusion.</p>	September 2021	Not yet due
<p>Annual Audit Letter</p> <p>This letter communicates the key issues arising from our work.</p>	October 2021	Not yet due

Sector Update

Local 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:

Public Sector

Local
government

The Redmond Review

The Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting – “The Redmond Review” was published on 8 September.

The review has examined the effectiveness of local audit and its ability to demonstrate accountability for audit performance to the public. It also considered whether the current means of reporting the Authority’s annual accounts enables the public to understand this financial information and receive the appropriate assurance that the finances of the authority are sound.

The Review received 156 responses to the Calls for Views and carried out more than 100 interviews. The Review notes “A regular occurrence in the responses to the calls for views suggests that the current fee structure does not enable auditors to fulfil the role in an entirely satisfactory way. To address this concern an increase in fees must be a consideration. With 40% of audits failing to meet the required deadline for report in 2018/19, this signals a serious weakness in the ability of auditors to comply with their contractual obligations. The current deadline should be reviewed. A revised date of 30 September gathered considerable support amongst respondents who expressed concern about this current problem. This only in part addresses the quality problem. The underlying feature of the existing framework is the absence of a body to coordinate all stages of the audit process.”

Key recommendations in the report include:

- A new regulator - the Office of Local Audit and Regulation (OLAR) to replace the Financial Reporting Council’s (FRC) role and that of Public Sector Auditor Appointments (PSAA)
- Scope to revise fees - the current fee structure for local audit be revised to ensure that adequate resources are deployed to meet the full extent of local audit requirements
- Move back to a September deadline for Local Authorities - the deadline for publishing audited local authority accounts be revisited with a view to extending it to 30 September from 31 July each year
- Accounts simplification - CIPFA/LASAAC be required to review the statutory accounts to determine whether there is scope to simplify the presentation of local authority accounts.

The OLAR would manage, oversee and regulate local audit with the following key responsibilities:

- procurement of local audit contracts;
- producing annual reports summarising the state of local audit;
- management of local audit contracts;
- monitoring and review of local audit performance;
- determining the code of local audit practice; and
- regulating the local audit sector.

The current roles and responsibilities relating to local audit discharged by the Public Sector Audit Appointments (PSAA); Institute of Chartered Accountants in England and Wales (ICAEW); FRC; and The Comptroller and Auditor General (C&AG) to be transferred to the OLAR.

How you can respond to the Review

One of the recommendations was for local authorities to implement:

The governance arrangements within local authorities be reviewed by local councils with the purpose of:

- an annual report being submitted to Full Council by the external auditor;
- consideration being given to the appointment of at least one independent member, suitably qualified, to the Audit Committee; and
- formalising the facility for the CEO, Monitoring Officer and Chief Financial Officer (CFO) to meet with the Key Audit Partner at least annually.

Whilst Redmond requires legislation, in practice the second and third bullets are things which authorities could start doing now.

The full report can be obtained from the gov.uk website:

<https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-independent-review>

Code of Audit Practice and revised approach to Value for Money audit work - National Audit Office

On 1 April 2020, the National Audit Office introduced a new Code of Audit Practice which comes into effect from audit year 2020/21. The most significant change in the Code is the introduction of a new 'Auditor's Annual Report', which brings together the results of all the auditor's work across the year. The Code also introduced a revised approach to the audit of Value for Money.

Value for Money - Key changes

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

- A new set of key criteria, covering governance, financial sustainability 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 (qualified / unqualified) 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 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
- Provide clearer recommendations to help local bodies improve their arrangements.

Implications of the changes

Grant Thornton very much welcomes the changes, which will support auditors in undertaking and reporting on work which is more meaningful, and makes impact with audited bodies and the public. We agree with the move away from a binary conclusion, and with the replacement of the Annual Audit Letter with the new Annual Auditor's Report. The changes will help pave the way for a new relationship between auditors and audited bodies which is based around constructive challenge and a drive for improvement.

The following are the main implications in terms of audit delivery:

- The Auditor's Annual Report will need to be published at the same time as the Auditor's Report on the Financial Statements.
- Where auditors identify weaknesses in Value for Money arrangements, there will be increased reporting requirements on the audit team. We envisage that across the country, auditors will be identifying more significant weaknesses and consequently making an increased number of recommendations (in place of what was a qualified Value for Money conclusion). We will be working closely with the NAO and the other audit firms to ensure consistency of application of the new guidance.
- The new approach will also potentially be more challenging, as well as rewarding, for audited bodies involving discussions at a wider and more strategic level. Both the reporting, and the planning and risk assessment which underpins it, will require more audit time, delivered through a richer skill mix than in previous years.

The Code can be accessed here:

https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2020/01/Code_of_audit_practice_2020.pdf

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 Authority 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
- Valuation of defined benefit net pension fund liabilities

The Authority's 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. 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 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 uncertainty 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). We would appreciate a prompt response to these enquires in due course.

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)

Future Procurement and Market Supply Options Review – Public Sector Audit Appointments

Public Sector Audit Appointments (PSAA) has commissioned an independent review of the sustainability of the local government audit market. The review was undertaken by an independent consultancy, Touchstone Renard.

PSAA note that the report “draws on the views of audit firms active in the local authority market as well as others that are not. In doing so it identifies a number of distinctive challenges in the current local audit market. In particular it highlights the unprecedented scrutiny and significant regulatory pressure on the auditing profession; the challenges of a demanding timetable which expects publication of audited accounts by 31 July each year; and the impact of austerity on local public bodies and its effect on both the complexity of the issues auditors face and the capacity of local finance teams”.

Key findings in the report include:

- A lack of experienced local authority auditors as the main threat to the future sustainability of the market.
- It will be difficult to bring the non-approved firms into the market.
- Of the nine approved firms, only five have current contracts with PSAA.
- Almost all of the approved firms have reservations about remaining in the market.
- Firms perceive that their risks have increased since bids were submitted for the current contracts.
- The timing of local audits is problematic.

Key issues for the next procurement round include:

- Number of lots and lot sizes.
- Lot composition.
- Length of contracts.
- Price:quality ratio.

The report notes that “PSAA will need to balance the views of the firms with wider considerations including the needs of audited bodies and the requirement to appoint an auditor to every individual body opting in to its collective scheme”.



The full report can be obtained from the PSAA website:

<https://www.psa.co.uk/wp-content/uploads/2020/03/PSAA-Future-Procurement-and-Market-Supply-Options-Review.pdf>

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 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>

