LANCASHIRE COMBINED FIRE AUTHORITY

AUDIT COMMITTEE
Meeting to be held on 20 July 2021

ACCOUNTING ESTIMATES 2020/21

Contact for further information:-
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Executive Summary

The introduction of ISA 540 means that Audit Committee need to fully understand the judgements and estimates made by management in the course of producing the Statement of Accounts.

The estimates as reported are included in the unaudited statement of accounts balances.

Recommendation

The Committee is asked to note and endorse the accounting estimates as reported.

Background

International Standard on Auditing (ISA) 540: Auditing Accounting Estimates and Related Disclosures, was revised in December 2018 by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body that serves the public interest by setting high-quality international standards for auditing, quality control, and review.

The auditing standard was revised because Statement of Accounts are increasingly subject to judgements and estimations performed by management and experts on a range of items within them, as required by current accounting standards. These changes require that auditors should understand and evaluate: "the nature and extent of oversight and governance that the entity has in place over management's financial reporting process relevant to the accounting estimates."

ISA 540 applies to any financial statements beginning on or after 15 December 2019 – for LFRS this means the 2020/21 financial statements onwards.

Requirements

Those Charged with Governance, ie Audit Committee need to understand what significant estimates will be included within the Statement of Accounts. Significant estimates are those that:

- Require significant judgement by management to address subjectivity;

- Have high estimation uncertainty;
- Are complex to make;
- Had, or ought to have had, a change in method, assumptions or data compared to previous periods; or
- Involve significant assumptions.

The Statement of Accounts contains estimated figures that are based on assumptions about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends or other relevant factors. However, because balances cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The Statement of Accounts are prepared in line with the most recent Code of Practice on Local Authority Accounting in the United Kingdom (known as the Code), published by CIPFA.

Significant underlying Assumption for 2020/21

The Statement of Accounts are prepared with the underlying significant assumption of Going Concern, which means that the Authority considers its' financial position to be stable for the foreseeable future, as assessed at the most recent budget setting exercise finalised in February 2021. The Future Financial Plans section of the narrative describes this in more detail.

Accounting standards require that management make an annual assessment of going concern, although the Code recognises that Local Authorities cannot be created or dissolved without statutory prescription, the accounts must therefore be prepared on a Going Concern basis. Management have prepared the assessment in line with requirements.

Significant Accounting Estimates for 2020/21

Nature of the estimate	Estimate value; degree of uncertainty; methodology
Valuation of land & buildings	2020/21 carrying value £99.5m (2019/20: £99.2m) The valuation method applied to LFRS assets is prescribed by the Code, these have not changed since the last financial year. The majority of the Property assets are valued under Depreciated Replacement Cost (DRC) as specialised assets. DRC is used as a valuation method when there are no recent market transactions due to the specialised nature of the asset (ie a Fire Station) to base a valuation on. DRC calculates the cost (at todays prices) of building the asset as it is currently used, then reduce by the valuer's assessment of the accumulated depreciation. Land and buildings are valued by a RICS qualified valuer (employed by Amcat Ltd) on a rolling 5-year basis for physical inspections, or upon completion of significant

	building works, with the remaining assets updated by desktop valuation using RICS indices. The 2019/20 valuations were subject to a higher degree of valuation uncertainty in terms of the market evidence used to form opinions of value, due to the global pandemic. Although this position has largely settled, the valuer notes continued market uncertainties in the wake of Brexit and Covid-19, and although materials costs remain high, investment market uncertainty has caused a slight downward trend since the last year. Management review the underlying assumptions prior to valuation, and review material changes to values to understand the reasons, or challenge the results with the valuer. The property valuation gain for 2020/21 is £4.1m (2019/20: £6.0m gain). It is estimated that a 1% increase in DRC values will increase asset values by £0.7m (2019/20: £0.7m). Property assets are also considered by the valuer for impairment each year, in terms of the condition of the asset, local property market conditions, current pricing of materials/labour (the basis for DRC valuations). There were no such impairments in 2020/21.
Depreciation of Property & Equipment	2020/21 carrying value £99.5m (2019/20: £99.2m) Assets are depreciated over the useful lives, dependent on assumptions about the level of repairs and maintenance that will be incurred in relation to individual assets. Useful lives are determined by the RICS valuer for Property assets, and by Fleet Services department for vehicles and equipment. Asset life changes are compared to the previous year by management to check for reasonableness. There have not been any significant changes in asset lives since last year. Property asset lives are assessed on physical inspection in 10-year bands up to a maximum of 50 years. Vehicle asset lives depend upon the vehicle type, usually between 4 and 15 years. Note - the useful life is used to account for the ‘using up’ of the asset, at point of asset disposal all our assets are still in saleable working order, for example a 12-year-old pumping appliance will reach £3k sale proceeds. If the useful life of assets is reduced, depreciation increases and the carrying value of the asset falls.

	It is estimated that the annual depreciation charge would increase by £0.1m for every year that asset lives were reduced. The depreciation charge for 2020/21 is £4.2m (2019/20: £3.9m).
Valuation of both FF and LGPS pension liability	2020/21 net liability carrying value £887.7m (2019/20: £812.7m) The liabilities of each scheme are calculated by qualified actuaries (Mercers for LGPS, and Government Actuary Department (GAD) for FF schemes) using detailed membership data at a point in time, adjusted for changes since the last full review. These calculations are based on complex judgements relating to the discount rates used, the rate at which salaries and pensions are projected to increase, mortality rate assumptions, and expected returns on pension fund assets (for LGPS only). These assumptions are proposed by the actuaries as experts in their field and are disclosed to management in advance of the year end valuations being calculated, giving the opportunity for scrutiny and challenge. The assumptions made, and the subsequent movement in the liabilities are reviewed by management to check for reasonableness, with any queries referred to the actuaries for resolution. It is estimated that, for both pension schemes combined, a 0.1% increase in the discount rate would decrease the liability by £16.7m (2019/20: £15.8m), a 0.1% increase in inflation would increase the liability by £15.1m (2019/20: £13.1m), a 0.1% increase in pay growth would increase the liability by £2.2m (2019/20: £2.0m). In addition, a 1 year increase in the assumed life expectancy would increase the liability by £8.6m (2019/20: £6.6m). The above rates are updated by the actuaries each year, which in turn affects the overall liability calculated.
Valuation of LGPS pension asset	2020/21 LGPS asset carrying value £68.3m (2019/20: £61.9m) The LGPS scheme assets attributable to the Authority are calculated by Mercers (with the Authority's 25% share in North West Fire Control calculated by Hymans Robertson LLP). The assets are valued using the value of assets as assessed at the last full valuation, taking account of any changes since then. The asset value is re-based at each full valuation.

	The Authority is attributed a proportionate share of the assets of the Lancashire County Pension fund, in line with all organisations participating in the scheme. Both the direct and indirect property assets held by the pension fund carry a risk of over/understating for the accounts, both in terms of the proportion attributed to the Authority, and the impact of market volatility seen during the global pandemic, although the actuaries consider this to have reduced since the last year end. The assumptions made, and the subsequent movement in the assets are reviewed by management to check for reasonableness, with any queries referred to the actuaries for resolution.
Fair value measurements – PFI schemes	2020/21 PFI liability carrying value £13.2m (2019/20: £13.6m); 2020/21 PFI liability fair value £17.3m (2019/20: £16.6m) The liability initial carrying value is calculated from the present value of the future payments due and grant received for the life of the PFI scheme. This carrying value is then updated each year to reflect any inflationary increases and any repayments made. The fair value is calculated using the forecast payments and grant income for the remaining life of the scheme and applying a discount rate (we use the current AA rated bond yield rate forecast) to arrive at the fair value. The Fair Value is the estimated price at which the Authority would transfer the liability to another body. As the fair value of the Authority's two PFI schemes cannot be measured based on quoted prices in active markets, their fair value is calculated using the Discounted Cash Flow method, which uses forecast future annual net cash flows to estimate the current value. In order to calculate the fair value, forecast bond yield rates are provided to us by LCC Treasury management section, who receive them from their Treasury Management advisors, Arlingclose. The bond yield rate forecasts have reduced since last year end, reflecting the reduction in expected future Bank of England base rate forecasts and the uncertainties about future economic recovery. This reduction in the future interest rates is reflected in the increased fair value of the liability, when the underlying liability has reduced by the repayments made during the year.

Expenditure accruals – pensionability of allowances	2020/21 total expenditure accrual £2.4m (2019/20: £2.4m) In line with the ongoing discussions with representative bodies regarding pensionability of allowances following the High Court ruling on Norman v Cheshire Fire Service in March 2019, the 2019/20 statement of accounts included an accrual of £2.4m, calculated as the Authority's potential liability in respect of backdated employers pension contributions should agreement be reached with representative bodies. This sum was calculated using historic payroll data and applying the relevant Firefighters pension scheme employer's contribution rates (which vary dependent on the scheme).
Revenue Accrual – S31 grant re business rates additional reliefs in 2020/21	2020/21 income accrual £1.9m (2019/20: nil) The 2020/21 accounts include an accrual of £1.9m in relation to additional business rates reliefs in respect of items such as retail, nursery and newspapers, announced in November 2020, to offset the shortfall carried forwards on the business rate collection fund at March 2021. This sum was calculated based on each billing authorities' initial estimate of the relief's impact on their collection fund and receipt of the final grant amount is expected to be received during quarter four of 2021/22, after the reconciliation of the year end billing authority business rates returns for 2020/21 which have a deadline of 7 July 2021.
Holiday pay expenditure accrual	2020/21 expenditure accrual £0.9m (2019/20: £0.8m) Each year end the Authority is required to calculate the balance owed to employees in relation to untaken annual leave, time owing and flexitime. Various systems and records are used to determine the underlying data, such as the payroll system for annual leave, the support staff flexitime system, and the on-call availability system. The relevant balances (by employee) then have the relevant payment rate applied to arrive at the accrual for the whole organisation. Note this balance is not expected to result in any cash payments to employees – it is simply recognising the cash value of outstanding balances at a point in time, in accordance with accounting rules.

In addition to the above, each year Executive Board are asked to consider whether there are any transactions, events, or conditions (or changes in these) that might trigger the recognition of an additional significant accounting estimate, or the potential recognition, known as a contingent liability.

Based on the returns received back from Executive Board, the contingent liabilities note has been updated to reflect the current position, but there were no further significant events or transactions identified by this process.

Financial Implications

As outlined in the report

Human Resource Implications

None

Equality and Diversity Implications

None

Environmental Impact

None

Business Risk Implications

If external audit does not consider that we have properly considered our estimates and significant judgements, we could be subject to a qualified audit opinion.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact
Reason for inclusion in Part II, if appropriate:		