Lancashire Combined Fire Authority
Audit Committee
Meeting to be held on 25 July 2023

Accounting Estimates 2022/23

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Executive Summary

The introduction of International Standard on Auditing (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 were 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 required 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."

Requirements

Those Charged with Governance, i.e., Audit Committee need to understand what significant estimates would be included within the Statement of Accounts. Significant estimates were 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 contained estimated figures that were based on assumptions about the future or that are otherwise uncertain. Estimates were made considering past and current trends and/or other relevant factors. However, because balances could not be determined with certainty, actual results could be materially different from the assumptions and estimates.

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

Significant underlying Assumption for 2022/23

The Statement of Accounts were prepared with the underlying significant assumption of Going Concern, which meant that the Authority considered its' financial position to be stable for the foreseeable future, as assessed at the most recent budget setting exercise finalised in February 2023.

Accounting standards required that management made an annual assessment of going concern, although the Code recognised that Local Authorities could not be created or dissolved without statutory prescription, the accounts must therefore be prepared on a Going Concern basis. Management had prepared the assessment in line with requirements.

Significant Accounting Estimates for 2022/23

Nature of the estimate	**Estimate value; degree of uncertainty; methodology**
Valuation of land & buildings	2022/23 carrying value £126m (2021/22: £108.9m) The valuation method applied to LFRS assets is prescribed by the Code, these had not changed since the last financial year. Most of the Property assets were valued under Depreciated Replacement Cost (DRC) as specialised assets. DRC was used as a valuation method when there were no recent market transactions due to the specialised nature of the asset (i.e., a Fire Station) to base a valuation on. DRC calculated the cost (at today's prices) of building the asset as it was currently used, then reduced it by the valuer's assessment of the accumulated depreciation. Land and buildings were valued by a Royal Institute of Chartered Surveyors (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 uncertainty in terms of the market evidence used to form opinions of value, continued. Shortly after the global pandemic, the war in Ukraine and resultant energy crisis had impacted on materials cost coupled with the void in the market for tradesmen because of Brexit, which had led to slippages in most construction targets. Management reviewed the underlying assumptions prior to valuation, and reviewed material changes to values and challenged the results with the valuers. To gain understanding of their valuation. The property valuation gains for 2021/22 was £22.3m (2021/22: £12.2m). It is estimated that a 1% increase in DRC values will increase asset values by £1.3m (2021/22: £0.9m). Property assets were 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 2022/23.
Depreciation of Property & Equipment	2022/23 carrying value £126m (2021/22: £108.9m) Assets were depreciated over the useful lives, dependent on assumptions about the level of repairs and maintenance that would be incurred in relation to individual assets. Useful lives were determined by the RICS valuer for Property assets, and by Fleet Services department for vehicles and equipment. Asset life changes were compared to the previous year by management to check for reasonableness. There had not been any significant changes in asset lives since last year. Property asset lives were assessed on physical inspection in 10-year bands up to a maximum of 50 years. Vehicle asset lives

	depended upon the vehicle type, usually between 4 and 15 years. Note - the useful life was used to account for the ‘using up’ of the asset, at point of asset disposal all our assets were still in saleable working order, for example a 12-year-old pumping appliance would reach £3k sale proceeds. If the useful life of assets was reduced, depreciation increased and the carrying value of the asset fell. The depreciation charge for 2022/23 was £5.6m (2021/22: £4.8m). The estimated annual depreciation charge for property would increase by £0.1m for every year that asset lives were reduced.
Valuation of both FF and LGPS pension liability	2022/23 net liability carrying value £619.6m (2021/22: £883.4m) The schemes liabilities, 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 were based on complex judgements relating to the discount rates used, the projected increased rates of salaries and pensions, mortality rate assumptions, and expected returns on pension fund assets (for LGPS only). These assumptions, proposed by the actuaries as experts in their field, disclosed to management in advance of the year end valuations calculations, giving the opportunity for scrutiny and challenge. These assumptions and the subsequent movement in the liabilities, reviewed by management to check for reasonableness, with any queries referred to the actuaries for resolution. It was estimated that, for both pension schemes combined, a 0.5% increase in the discount rate would decrease the liability by £47m (2021/22: £8m), a 1% increase in pay growth would increase the liability by £13m (2021/22: £34m). In addition, a 1-year increase in the assumed life

	expectancy would increase the liability by £17m (2021/22: £8.5m). The above rates were updated by the actuaries each year, which in turn affected the overall liability calculated.
Valuation of LGPS pension asset	2022/23 LGPS asset carrying value £75.1m (2021/22: £76.7m) The LGPS scheme assets attributable to the Authority were calculated by Mercers (with the Authority's 25% share in North West Fire Control calculated by Hymans Robertson LLP). The assets were valued using the value of assets as assessed at the last full valuation, taking account of any changes since then. The asset value was re-based at each full valuation. The Authority was 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 carried 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 considered this to have reduced since the last year end. The assumptions made, and the subsequent movement in the assets were reviewed by management to check for reasonableness, with any queries referred to the actuaries for resolution.
Fair value measurements – PFI schemes	2022/23 PFI liability carrying value £12.3m (2021/22: £12.8m); 2022/23 PFI liability fair value £13.5m (2021/22: £15.9m) The liability initial carrying value was calculated from the present value of the future payments due and grant received for the life of the PFI scheme. This carrying value was then updated each year to reflect any inflationary increases and any repayments made. The fair value was 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 was 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 could not be measured based on quoted prices in active markets, their fair value was calculated using the Discounted Cash Flow method, which used forecast future annual net cash flows to estimate the current value. In order to calculate the fair value, forecast bond yield rates were provided to us by LCC Treasury management section, who received them from their Treasury Management advisors, Arlingclose. The bond yield rate forecasts had increased since last year end, reflecting the increase in expected future Bank of England base rate forecasts. The reduction in the fair value of the liability, was a product of both the underlying reduction in the liability as a result of repayments made during the year, and the increase in the future interest rates.
Holiday pay expenditure accrual	2022/23 expenditure accrual £1m (2021/22: £0.8m) Each year end, the Authority was required to calculate the balance owed to employees in relation to untaken annual leave, time owing and flexitime. Various systems and records were 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 had the relevant payment rate applied to arrive at the accrual for the whole organisation. Note this balance was not expected to result in any cash payments to employees – it was 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 were asked to consider whether there were 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 had 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

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.

Environmental Impact
None

Equality and Diversity Implications
None

Human Resource Implications
None

Local Government (Access to Information) Act 1985

List of background papers
N/a