

Audit Progress Report and Sector Update

Herefordshire Council
Year ending 31 March 2020

16 June 2020



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Introduction



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This paper provides the Audit 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)



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Members of the Audit 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 June 2020

Financial Statements Audit

We began our planning for the 2019/20 audit in January, and we began our interim audit in January 2020 and completed in March 2020. Our interim fieldwork included:

- Updated review of the Council's control environment
- Updated understanding of financial systems
- Review of Internal Audit reports on core financial systems
- Early work on emerging accounting issues
- Early substantive testing

In January we issued a detailed audit plan, setting out our proposed approach to the audit of the Council's 2019/20 financial statements.

We have no issues to bring to your attention as a result of our interim audit.

We will report our work in the Audit Findings Report and aim to give our opinion on the Statement of Accounts by 30 November 2020.

Value for Money

The scope of our work is set out in the guidance issued by the National Audit Office. The Code requires auditors to satisfy themselves that; "the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources".

The guidance confirmed the overall criterion as: "in all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people".

The three sub criteria for assessment to be able to give a conclusion overall are:

- Informed decision making
- Sustainable resource deployment
- Working with partners and other third parties

Details of our initial risk assessment to determine our approach are included in our Audit Plan.

We will report our work in the Audit Findings Report and aim to give our Value For Money Conclusion by 30 November 2020.

The NAO has consulted on a new Code of Audit Practice and published a draft version. Subject to Parliamentary approval the new Code will come into force no later than 1 April 2020 and includes significant changes to the auditor's Value for Money work. Please see page 9 for more details.

Progress at June 2020 (Cont.)

Other areas

Meetings

We met with Finance Officers in November 2019 as part of our quarterly liaison meetings and virtually in May 2020 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 Council. Your officers attended our Financial Reporting Workshop in February, which will help to 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 Deliverables

2019/20 Deliverables	Planned Date	Status
<p>Fee Letter</p> <p>Confirming audit fee for 2019/20.</p>	April 2019	Complete
<p>Audit Plan</p> <p>We are required to issue a detailed audit plan to the Audit and Governance Committee setting out our proposed approach in order to give an opinion on the Council's 2019-20 financial statements and a Conclusion on the Council's Value for Money arrangements.</p>	January 2020	Complete
<p>Interim Audit Findings</p> <p>We will provide an update on our interim audit during the Audit and Governance Committee</p>	June 2020	Complete
<p>Audit Findings Report</p> <p>The Audit Findings Report will be reported to the November Audit and Governance Committee.</p>	November 2020	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>	November 2020	Not yet due
<p>Annual Audit Letter</p> <p>This letter communicates the key issues arising from our work.</p>	TBC	Not yet due

COVID-19 Update

Impact on working arrangements:

- following the government's announcement on Monday 16th March, we have closed our offices for the foreseeable future and your audit team are now working from home
- we will therefore be working remotely during the accounts audit and have discussed the logistics of these arrangements with the finance team.
- although there are some audit tasks which are best undertaken in person, the majority of the audit will be able to be completed remotely. This is however likely to make the audit process longer. We will work closely with the finance team to make this different way of working as efficient as possible.
- we acknowledge there may need to be further changes to planned audit timings due to potential illness within the audit team or the finance team and due to the further developments of COVID-19.

Impact on accounts and audit opinions:

The following sets out a number of the key issues which finance teams will need to consider as part of the year end closedown.

- Impact on reserves and financial health and whether the audited body needs to provide additional disclosures that draw attention to a Material Uncertainty around Going Concern (this could also impact on the VfM conclusion).
- Impact on property valuations and whether these contain a material uncertainty clause.
- Impact on collectability of debt and assumptions made in bad debt provisions.
- Impact on post-balance sheets events (the consequences of the virus post 31 March 2020 will generally be non-adjusting post balance sheet events but some form of disclosure may be needed).
- Disclosure of impact in annual report.
- Disclosure of critical judgements.
- Disclosure of material estimation uncertainties.
- Impact on the content of the Annual Governance Statement, particularly with regards to risks, controls and mitigation.
- Considerations in respect of service continuity and disaster planning arrangements (this could impact on the VfM conclusion).
- Impact on reporting to those charged with governance and signing arrangements.

Changes to Local Authority reporting timetables and requirements:

- The new date for publication for final, audited 2019/20 accounts is 30 November 2020, a change from 31 July for local authorities.
- The formal 10-working-day public inspection period must start by 1 September 2020. In effect, this means that draft accounts must be approved by 31 August 2020 at the latest, although local authorities are still encouraged to approve them earlier, wherever possible.
- Although the implementation of IFRS 16 has been delayed to 1 April 2021, the Council should still disclose the expected impact of its initial application in their 2019/2020 statements. As a minimum, we would expect the Council to disclose the title of the standard, the date of initial application and the nature of the changes in accounting policy for leases. If the financial impact of IFRS 16 is not known or reasonably estimable, the accounts should state this.
- given this is a developing situation, there may be further changes to the accounts process for 2019/20 and we will be in regular dialogue with the finance team over the coming weeks.

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

Brydon Review – the quality & effectiveness of audit

The Brydon review is an independent review, led by Sir Donald Brydon, which has looked at the quality and effectiveness of audit, seeking to make proposals that will improve the UK audit ‘product’. The review has examined the nature and scope of audit from a user perspective and seeks to clarify and potentially close the ‘expectation gap’ (ie what stakeholders and society expect from audit compared to what it delivers today).

A full list of Sir Donald’s recommendations can be found online, and a brief summary is provided below:

- Redefinition of audit and its purpose
- Creation of a corporate auditing profession, governed by principles
- Introduction of suspicion into the qualities of auditing
- Extension of the concept of auditing to areas beyond financial statements
- Mechanisms to encourage greater engagement of shareholders with audit and auditors
- Change in language of the opinion given by auditors
- Introduction of a corporate Audit and Assurance Policy, a Resilience Statement and a Public Interest Statement
- Suggestions to inform the work of BEIS on internal controls and improve clarity on capital maintenance
- Greater clarity around the roles of the audit committee
- A package of measures around fraud detection and prevention
- Improved auditor communication and transparency
- Obligations to acknowledge external signals of concern
- Extension of audit to new areas including Alternative Performance Measures
- Increased use of technology

On the auditor’s responsibility to detect fraud, Jonathan Riley, Grant Thornton Head of Quality and Reputation, said: “We are pleased to note that Sir Donald Brydon makes it clear that not only is there an expectation gap in relation to the purpose of audit and the detection of fraud but that the current ISAs need revision, and training of corporate auditors need to be enhanced, in order to allow auditors to better detect fraud. This is further reinforced by the new ability to make it easier for users of accounts, not just management, to inform the auditor of concerns relating to financial statements.”

“Notwithstanding these proposals, it is neither possible or desirable for an auditor to test in detail every transaction of the company and so materiality will still exist. In addition, a fraud involving collusion and sophistication may still prove extremely hard to detect.”

Grant Thornton welcomes the consideration given by Sir Donald on the quality and effectiveness of audit. These recommendations should bring far greater clarity and transparency to the profession and ultimately result in an audit regime that allows auditors to better assess, assure and inform all users of financial accounts.

Crucially, the Government must now consider these recommendations not just in context of earlier inquiries into the profession, but also against the backdrop of global trade and Britain’s future role as a pillar of global commerce. The report places new obligations not only on auditors, but also on company directors. Together with other regulations such as the revised Ethical Standard and wider corporate governance requirements, the proposed changes need to strike the right balance and not dent our place on the world’s financial stage. Careful explanation particularly of what this means to those fast growing mid-sized public entities seeking capital will be necessary.

The public perception of audit remains weak and failures continue to happen, so we agree that now is the right time to explore what needs to change to ensure that audit is fit for modern day business and meets the public interest. The report should contribute heavily towards this outcome.

Link to the full report and full list of recommendations:

<https://www.gov.uk/government/publications/the-quality-and-effectiveness-of-audit-independent-review>

Redmond Review – Review of local authority financial reporting and external audit

The independent review led by Sir Tony Redmond sought views on the quality of local authority financial reporting and external audit. The consultation ran from 17 September 2019 to 20 December 2019.

Grant Thornton provided a comprehensive submission, We believe that local authority financial reporting and audit is at a crossroads. Recent years have seen major changes. More complex accounting, earlier financial close and lower fees have placed pressure on authorities and auditors alike. The target sign-off date for audited financial statements of 31 July has created a significant peak of workload for auditors. It has made it impossible to retain specialist teams throughout the year. It has also impacted on individual auditors' well-being, making certain roles difficult to recruit to, especially in remote parts of the country.

Meanwhile, the focus on Value for Money, in its true sense, and on protecting the interests of citizens as taxpayers and users of services are in danger of falling by the wayside. The use of a black and white 'conclusion' has encouraged a mechanistic and tick box approach, with auditors more focused on avoiding criticism from the regulator than on producing Value for Money reports that are of value to local people.

In this environment, persuading talented people to remain in the local audit market is difficult. Many of our promising newly qualified staff and Audit Managers have left the firm to pursue careers elsewhere, often outside the public sector, and almost never to pursue public audit at other firms. Grant Thornton is now the only firm which supports qualification through CIPFA. It is no longer clear where the next generation of local auditors will come from.

We believe that now is the time to reframe both local authority financial reporting and local audit. Specifically, we believe that there is a need for:

- More clearly established system leadership for local audit;
- Simplified local authority financial reporting, particularly in the areas of capital accounting and pensions;

- Investing in improving the quality of financial reporting by local bodies;
- A realistic timescale for audit reporting, with opinion sign off by September each year, rather than July;
- An increase in audit fees to appropriate levels that reflect current levels of complexity and regulatory focus;
- A more tailored and proportional approach to local audit regulation, implementing the Kingman recommendations in full;
- Ensuring that Value for Money audit work has a more impactful scope, as part of the current NAO Code of Audit Practice refresh;
- Introducing urgent reforms which help ensure future audit arrangements are sustainable and attractive to future generations of local audit professionals.

We note that Sir Donald Brydon, in his review published this week, has recommended that *“the Audit, Reporting and Governance Authority (ARGA) (the proposed new regulatory body) should facilitate the establishment of a corporate auditing profession based on a core set of principles. (This should include but not be limited to) the statutory audit of financial statements.”* Recognising the unique nature of public audit, and the special importance of stewardship of public money, we also recommend that a similar profession be established for local audit. This should be overseen by a new public sector regulator.

As the reviews by John Kingman, Sir Donald Brydon, and the CMA have made clear, the market, politicians and the media believe that, in the corporate world, both the transparency of financial reporting and audit quality needs to be improved. Audit fees have fallen too low, and auditors are not perceived to be addressing the key things which matter to stakeholders, including a greater focus on future financial stability. The local audit sector shares many of the challenges facing company audit. All of us in this sector need to be seen to be stepping up to the challenge. This Review presents a unique opportunity to change course, and to help secure the future of local audit, along with meaningful financial reporting.

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National Audit Office – Code of Audit Practice

The Code of Audit Practice sets out what local auditors of relevant local public bodies are required to do to fulfil their statutory responsibilities under the Local Audit and Accountability Act 2014. ‘Relevant authorities’ are set out in Schedule 2 of the Act and include local councils, fire authorities, police and NHS bodies.

Local auditors must comply with the Code of Audit Practice.

Consultation – New Code of Audit Practice from 2020

Schedule 6 of the Act requires that the Code be reviewed, and revisions considered at least every five years. The current Code came into force on 1 April 2015, and the maximum five-year lifespan of the Code means it now needs to be reviewed and a new Code laid in Parliament in time for it to come in to force no later than 1 April 2020.

In order to determine what changes might be appropriate, the NAO consulted on potential changes to the Code in two stages:

Stage 1 involved engagement with key stakeholders and public consultation on the issues that are considered to be relevant to the development of the Code.

The NAO received a total of 41 responses to the consultation which included positive feedback on the two-stage approach to developing the Code that has been adopted. The NAO stated that they considered carefully the views of respondents in respect of the points drawn out from the [Issues paper](#) and this informed the development of the draft Code. A summary of the responses received to the questions set out in the [Issues paper](#) can be found below.

[Local audit in England Code of Audit Practice – Consultation Response \(pdf – 256KB\)](#)

Stage 2 of the consultation involved consulting on the draft text of the new Code. To support stage 2, the NAO published a consultation document, which highlighted the key changes to each chapter of the draft Code. The most significant changes are in relation to the Value for Money arrangements. The draft Code includes three specific criteria that auditors must consider:

- Financial sustainability: how the body plans and manages its resources to ensure it can continue to deliver its services;
- Governance: how the body ensures that it makes informed decisions and properly manages its risks; and
- Improving economy, efficiency and effectiveness: how the body uses information about its costs and performance to improve the way it manages and delivers its services.

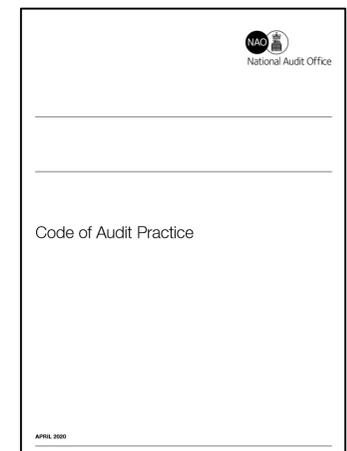
The auditor will be required to provide a commentary on the arrangements in place to secure value for money. Where significant weaknesses are identified the auditor should make recommendations setting out

- Their judgement on the nature of the weakness identified
- The evidence on which their view is based
- The impact on the local body
- The action the body needs to take to address the weakness

The consultation document and a copy of the new Code can be found on the NAO website. The new Code will apply from audits of local bodies’ 2020-21 financial statements onwards.

Link to NAO webpage for the new Code:

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



Financial Reporting Council – aid to Audit Committees in evaluating audit quality

On 19 December the Financial Reporting Council (FRC) issued an update of its Practice Aid to assist audit committees in evaluating audit quality in their assessment of the effectiveness of the external audit process.

The FRC notes that, “The update takes account of developments since the first edition was issued in 2015, including revisions of the UK Corporate Governance Code, the requirement for all Public Interest Entities (PIEs) to conduct a tender at least every 10 years and rotate auditors after at least 20 years, and increasing focus generally on audit quality and the role of the audit committee. It also takes account of commentary from audit committees suggesting how the Practice Aid could be more practical in focus and more clearly presented.

The framework set out in the Practice Aid focuses on understanding and challenging how the auditor demonstrates the effectiveness of key professional judgments made throughout the audit and how these might be supported by evidence of critical auditor competencies. New sections have been added addressing the audit tender process, stressing that high-audit quality should be the primary selection criterion, and matters to cover in audit committee reporting.

As well as illustrating a framework for the audit committee's evaluation, the Practice Aid sets out practical suggestions on how audit committees might tailor their evaluation in the context of the company's business model and strategy; the business risks it faces; and the perception of the reasonable expectations of the company's investors and other stakeholders. These include examples of matters for the audit committee to consider in relation to key areas of audit judgment, and illustrative audit committee considerations in evaluating the auditor's competencies.

The FRC encourages audit committees to use the Practice Aid to help develop their own approach to their evaluation of audit quality, tailored to the circumstances of their company. Audit committees are encouraged to see their evaluation as integrated with other aspects of their role related to ensuring the quality of the financial statements – obtaining evidence of the quality of the auditor's judgments made throughout the audit, in identifying audit risks, determining materiality and planning their work accordingly, as well as in assessing issues.”



The Practice Aid can be obtained from the FRC website:

<https://www.frc.org.uk/getattachment/68637e7a-8e28-484a-aec2-720544a172ba/Audit-Quality-Practice-Aid-for-Audit-Committees-2019.pdf>

Implementation of International Financial Reporting Standard 16 *Leases*

IFRS 16 *Leases*, as interpreted and adapted for the public sector, will be effective from 1 April 2020.

Background

IFRS 16 *Leases* was issued by the International Accounting Standards Board (IASB) in January 2016 and is being applied by HM Treasury in the Government Financial Reporting Manual from 1 April 2020. Implementation of the Standard will be included in the *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) for 2020/21.

The new Standard replaces the current leasing standard IAS 17 and related interpretation documents IFRIC 4, SIC 15 and SIC 27 and it sets out the principles for the recognition, measurement, presentation and disclosure of leases. The IASB published IFRS 16 because it was aware that the previous lease accounting model was criticised for failing to provide a faithful representation of leasing transactions.

Impact on 2019/20 financial statements

Whilst the new Standard is effective from 1 April 2020, authorities are required by the Code to *'disclose information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted'*. This requirement of the Code (3.3.4.3) reflects the requirements of paragraph 30 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

In the 2019/20 financial statements we would therefore expect to see authorities make disclosures including:

- the title of the Standard
- the date of implementation
- the fact that the modified retrospective basis of transition is to be applied, with transition adjustments reflected through opening reserves
- known or reasonably estimable information relevant to assessing the possible impact that application will have on the entity's financial statements, including the impact on assets, liabilities, reserves, classification of expenditure and cashflows
- the basis for measuring right of use assets on transition
- the anticipated use of recognition exemptions and practical expedients recognising that what is sufficient disclosure for one body may not be sufficient for another

Information needed for 2019/20 financial statements

In order to make disclosures in 2019/20, a significant amount of data will be needed, most significantly:

- a complete list of leases previously identified under IAS 17 and IFRIC 4
- details of non-cancellable lease terms, purchase options, extension and termination options
- details of lease arrangements at peppercorn or NIL rental
- anticipated future cash flows and implicit interest rates or incremental borrowing rates to enable calculation of lease liabilities

Audit work on IFRS 16 transition

At this stage, we would expect you to have:

- determined whether the impact of IFRS 16 will be material for your authority
- raised awareness of the new Standard across the authority, potentially including procurement, estates, legal and IT departments
- assessed the completeness and accuracy of your lease register and taken action if necessary
- formalised and signed existing lease documentation
- identified leases of low value assets and leases with short terms
- considered whether liaison with valuation experts is necessary
- started to draft your 2019/20 disclosure note
- started to embed processes to capture the data necessary to manage the ongoing accounting implications of IFRS 16

and that you are monitoring progress against an approved IFRS 16 implementation plan. Your local engagement team will be in touch to discuss your progress with IFRS 16 implementation and audit working paper requirements.

Implementation of International Financial Reporting Standard 16 *Leases*

Further information and guidance

CIPFA published their 2020/21 Code consultation on 12 July 2019, including an Appendix concerned with IFRS 16 implementation, further details can be found at:

<https://www.cipfa.org/policy-and-guidance/consultations-archive/code-of-practice-on-local-authority-accounting-in-the-united-kingdom-202021?crdm=0>

HM Treasury published IFRS 16 Application Guidance in December 2019 which can be found at:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/853238/IFRS_16_Application_Guidance_December_2019.pdf

CIPFA's IFRS 16 'Early guide for local authority practitioners' is available at:

<https://www.cipfa.org/policy-and-guidance/publications/i/ifrs-16-leases-an-early-guide-for-local-authority-practitioners>

IFRS 16 has been adopted a year earlier in the commercial sector. The Financial Reporting Council has published an IFRS 16 Thematic Review '*Review of Interim Disclosures in the First Year of Application*', containing key findings from their review and providing helpful insights into important disclosure requirements. The FRC's publication is available at:

<https://www.frc.org.uk/getattachment/a0e7c6e7-67d0-40fe-b869-e5cc589afe79/IFRS-16-thematic-review-2019-optimised.pdf>

Financial Reporting



Challenge question:

Does your authority have a project plan in place in relation to IFRS 16 *Leases* implementation?

Is your authority's progress against the project plan on track?

CIPFA Financial Resilience Index

The Chartered Institute of Public Finance & Accountancy's (CIPFA) Financial Resilience Index is a comparative tool designed to provide analysis on resilience and risk and support good financial management.

CIPFA note "The index shows a council's position on a range of measures associated with financial risk. The selection of indicators has been informed by the extensive financial resilience work undertaken by CIPFA over the past four years, public consultation and technical stakeholder engagement. The index is made up of a set of indicators. These indicators take publicly available data and compare similar authorities across a range of factors. There is no single overall indicator of financial risk, so the index instead highlights areas where additional scrutiny should take place in order to provide additional assurance. This additional scrutiny should be accompanied by a narrative to place the indicator into context."

At the launch of the index in December, CIPFA commented " the index analyses council finances using a suite of nine measures including level of reserves, rate of depletion of reserves, external debt, Ofsted judgements and auditor value for money assessments."

CIPFA found that against these indicators the majority of councils are not showing signs of stress. But around 10% show "some signs of potential risk to their financial stability.



The Financial Resilience tool is available on the CIPFA website below:

<https://www.cipfa.org/services/financial-resilience-index/>

Financial Resilience

Challenge question:

Has your Authority used the CIPFA index and fed back the key messages?

