

Audit Progress Report and Sector Update

Swale Borough Council
Year ending 31 March 2021

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 Council.

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

2019/20 audit

Financial statements

We have completed our audit of the Council's 2019/20 financial statements. Our audit opinion, including our value for money conclusion and certificate of audit closure, was issued on 27 November 2020. Our Annual Audit Letter summarising the outcomes of our audit is included as a separate item on today's agenda.

Housing Benefit subsidy claim

Our work to certify the Council's 2019/20 housing benefit subsidy claim is currently in progress. We anticipate that our work will be completed to allow certification of the claim by 28 February 2021, the extended deadline agreed with DWP. The outcomes from our work will be reported to the July 2021 Audit Committee.

2020/21 audit

Audit planning

Our planning for the 2020/21 financial statements audit will commence in March 2021. Our work will include;

- review of relevant sector information to capture any emerging issues and consider these as part of audit planning.
- discussions with management and review of key agenda papers and minutes to inform our risk assessment;
- updating our understanding of the Council's control environment and financial systems, including walkthrough testing to confirm that the design of systems is in accordance with our understanding; and
- understanding and assessing the Council's internal controls over accounting estimates as required under revised ISA540.

Due to the pandemic significantly more time has been required to complete our work on 2019/20 audits across the public sector. The pandemic will have a continuing impact on the timing of our work for 2020/21 audits, with planning work commencing later than in previous years and with some testing performed at yearend rather than as part of interim procedures. Our 2020/21 audit planning work will again be performed remotely due to the impact of the pandemic. We will liaise with management on any relevant issues.

Our 2020/21 audit plan will be presented to the July 2021 Audit Committee.

Accounts workshops for local government

In 2020/21 Grant Thornton are again running technical workshops for the preparers of local government accounts.

An invitation to the workshops will be sent to the Council's finance team

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 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 in the "Sector Update" section, and at: <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>

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

Audit Deliverables

2020/21 Deliverables	Planned Date	Status
<p>Accounts Audit Plan</p> <p>We are required to issue a detailed accounts audit plan to the Audit Committee setting out our proposed approach in order to give an opinion on the Council's 2020-21 financial statements.</p>	July 2021	Not yet due
<p>Audit Findings (ISA260) Report</p> <p>The Audit Findings Report will be reported to the September Audit Committee.</p>	September 2021	Not yet due
<p>Auditor's Annual Report</p> <p>The key output from local audit work on arrangements to secure VFM is an annual commentary on arrangements, which will be published as part of the Auditor's Annual Report (AAR). The final version of the AAR will be published at the same time as the Auditor's Report.</p>	September 2021	Not yet due
<p>Auditor's Report</p> <p>This is the opinion on your financial statement and Annual Governance Statement.</p>	September 2021	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

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 2020.

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>

The Redmond Review – Local Government audit and financial reporting

Scope

- Launched September 2019.
- Led by Sir Tony Redmond, former President of CIPFA.

Purpose

To assess the:

- Effectiveness of audit in local authorities; and
- Transparency of financial report.

Context – Why the need for a review?

Local audit is facing an unprecedented set of challenges:

- Accounts have grown far more complex
- Authorities are engaging in more innovative/unusual transactions
- Austerity has reduced the ability of many authorities to prepare high quality accounts and working papers
- Audit fees have fallen to an unsustainably low level
- The sign off date of 31 July is too tight, even without Covid-19 pressures
- Retention of audit staff is very difficult in this environment
- Authorities are not getting the service they deserve
- Radical and urgent reform is needed

Areas of focus – It is a wide-ranging review

- The expectations gap
- Audit and wider assurance
- Audit quality
- The financial reporting framework
- Auditor reporting

The review had 156 responses, over 100 interviews were held, the report runs to 83 pages with 23 recommendations.

The system is not working



The current local audit arrangements fail to deliver, in full, policy objectives underpinning the 2014 Act.

As a result, the overriding concern must be a lack of coherence and public accountability within the existing system.

The local audit market is very fragile. The current fee structure does not enable auditors to fulfil the role in an entirely satisfactory way.

Without prompt action to implement the recommendations, there is a significant risk that the firms currently holding local audit contracts will withdraw from the market.

Covering letter to the Secretary of State

- The local audit market is very fragile. The current fee structure does not enable auditors to fulfil the role in an entirely satisfactory way.
- 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.
- In addition, the ambition of attracting new firms to the local authority market has not been realised.

The Redmond Review – Local Government audit and financial reporting

Detailed findings

Systems leadership is lacking

- The structure is fragmented and piecemeal. Public sector specialist expertise is now dispersed around different bodies. No one body is looking for systematic problems, and there is no apparent co-ordination between parties to determine and act on emerging risks (Sir John Kingman).
- There is a need for a new organisation with the clarity of mission and purpose to act as the system leader for the local audit framework; and for a standardised statement of service information and costs, compared to the annual budget, that is aimed at taxpayers and service users.

Procurement has resulted in fees which are too low

- PSAA adopted the same procurement framework in 2017 as the Audit Commission had done previously in 2014. No assessment of the amount it would cost to audit each local authority, based on their level of audit risk, has been made in the past ten years.
- Audit fees in the local authority sector have dropped significantly at the same time that audit fees in other sectors, including other parts of the public sector, have significantly risen.
- Firms stated that the lack of profitability changes the way that local audit work is perceived within the firm. Specialising in this area is seen by many auditors as having a detrimental impact on career prospects.

The audit timescale is unrealistic and unhelpful

- The compression of the audit timetable was mentioned as an issue by every audit firm. Firms raised concerns about the resulting peaks in workload, pressures on staff during summer months, and knock-on effects when target dates are not met. These pressures contribute to making work unpopular with local audit staff.

Financial reporting is overly complex/not always relevant

- Local authority accounts are arguably more complex and more challenging for a service user to understand than accounts produced by other parts of the public sector.
- Scope identified to improve transparency and relevance of reporting, e.g.:
 - Asset valuations: accounting is complex and the perception of many stakeholders is that it does not add value.
 - Going concern disclosures are perceived to be less relevant in a local authority context than financial resilience.

Governance and transparency of reporting needs improvement

- The ability of audit committees, which mostly lack independent, technically qualified members, to consider effectively audit reports has been challenged in responses to the call for views.
- Transparency and accountability of audit reports, from a public perspective, is lacking.
- There needs to be a greater role for full council and a stronger interface between statutory officers and audit.

There is too much focus on Property and Pension Valuations

- Authorities concerned that auditors are spending significant time on fixed asset and pension valuations, rather than on major areas of expenditure and usable reserves. Auditors coming through the system are not developing wider understanding of LG context.
- Firms would prefer to do less work on asset and pension valuations but explained that these areas are given more attention to secure a positive assessment from the FRC.
- The FRC believes that if a focus on asset and pension valuations is inappropriate, this is the responsibility of CIPFA/LASAAC.

The Redmond Review – Local Government audit and financial reporting

Sir Tony's recommendations

A call for action

- **A new regulator** – The Office of Local Audit and Regulation to replace the FRC and PSAA.
- **Scope to increase fees** – The current fee structure for local audit to be revised (i.e. increased) to ensure that adequate resources are deployed to meet the full extent of local audit requirements.
- **Move back to a September deadline** – 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.
- Recognition of the **role of authorities in improving governance and reporting**; and
- Development of **audited and reconciled accounts summaries**.

Where next?

- Consultation
- Legislation
- Immediate actions

Given the urgency, it is imperative to introduce change where possible now, even ahead of legislation.

Grant Thornton's View

Sir Tony Redmond's report provides a clear road map to secure appropriate scrutiny and a sustainable future for local government audit. Reinforcing transparency and accountability is critical in protecting the interests of citizens who both fund and rely on the services delivered by local authorities. Introducing an Office of Local Audit and Regulation will help simplify and re-energise this vital public function at a time when local finances and governance are in need of effective oversight. We look forward to supporting Sir Tony and Government as this report progresses from recommendation to reality.

Value for Money arrangements

Revised approach to Value for Money work for 2020/21

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.

The Code require auditors to consider whether the body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. When reporting on these arrangements, the Code requires auditors to structure their commentary on arrangements under three specified reporting criteria. These are as set out to the right:



Improving economy, efficiency and effectiveness

Arrangements for improving the way the body delivers its services. This includes arrangements for understanding costs and delivering efficiencies and improving outcomes for service users.



Financial Sustainability

Arrangements for ensuring the body can continue to deliver services. This includes planning resources to ensure adequate finances and maintain sustainable levels of spending over the medium term (3-5 years)



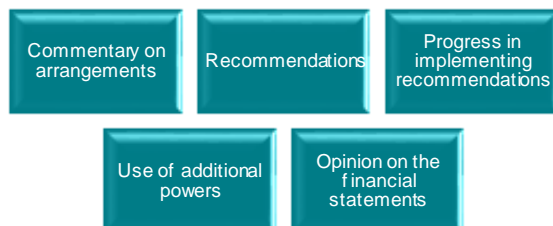
Governance

Arrangements for ensuring that the body makes appropriate decisions in the right way. This includes arrangements for budget setting and management, risk management, and ensuring the body makes decisions based on appropriate information



Auditor's Annual Report

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:



- **Commentary on arrangements:** This 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 AFR, or a verbatim repeat of it – it is simply a summary of what the opinion audit found.

Risks of significant VFM weaknesses

As part of our planning work, we will consider whether there are any risks of significant weakness in the body's arrangements for securing economy, efficiency and effectiveness in its use of resources that we needed to perform further procedures on.

The risks we identify will be detailed in our Audit Plan, along with the further procedures we will perform.

Potential types of recommendations

A range of different recommendations could be made following the completion of work on risks of significant weakness, as follows:



Statutory recommendation

Written recommendations to the body under Section 24 (Schedule 7) of the Local Audit and Accountability Act 2014. A recommendation under schedule 7 requires the body to discuss and respond publicly to the report.



Key recommendation

The Code of Audit Practice requires that where auditors identify significant weaknesses in arrangements to secure value for money they should make recommendations setting out the actions that should be taken by the body. We have defined these recommendations as 'key recommendations'.



Improvement recommendation

These recommendations, if implemented should improve the arrangements in place at the body, but are not made as a result of identifying significant weaknesses in the body's arrangements

Further information

To review the new Code and AGN03, visit the NAO's website using the link below:

<https://www.nao.org.uk/code-audit-practice/code-of-audit-practice-consultation/>

Accounting estimates and related disclosures

The Financial Reporting Council issued an updated ISA (UK) 540 (revised): *Auditing Accounting Estimates and Related Disclosures* which 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

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.

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. asset valuations and pensions liabilities. 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 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 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 detail:

- 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).

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)



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