Audit Progress Report and Sector Update

Warwickshire County Council and Warwickshire Pension Fund
Year ending 31 March 2021

25 March 2021

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Introduction

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This paper provides the Audit and Standards 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)

Members of the Audit and Standards 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

Working with you

Changes in the Engagement Team

Grant Patterson has served as engagement lead for the County Council and Pension Fund for the last five years and therefore in line with ethical standards will be stepping down as the Council's Engagement Lead (EL). John Gregory will be picking up those responsibilities from him. John has previously been the Council's EL but sufficient time has elapsed such that he is now able to return under ethical standards. John has extensive experience in the sector and looks forward to working with the Council again and forging strong working relationships with management and those charged with governance as the Council continues to navigate challenging times. John's CV can be found on page 11.

Meetings

John has had introductory meetings with the finance team since the beginning of 2021. We also met with Finance Officers and the Strategic Director for Resources in March as part of audit planning for 2020/21. We continue to be in discussions with finance staff regarding emerging developments and to ensure the audit process is smooth and effective.

Events

Our annual chief accountant workshops have recently taken place. Delivered virtually this year, we offered break-out areas to provide opportunities for your finance officers to speak to peers across the sector in addition to gaining an understanding of the key changes impacting this year's accounts.

Working Arrangements

We envisage having to continue to work completely remotely for a longer period. Working with the Council and Pension Fund we managed this well at the last audit and we will seek to be in regular contact with your finance team in respect of the logistics of these arrangements, recognising that staff welfare during the pandemic will be your priority.

2019/20

Certification of claims and returns

Following on from the meeting of the Audit and Standards Committee on 5 November 2020 we have now certified the Council's Teachers Pensions' EOYC form in accordance with agreed procedures. The certification work for the 2019/20 claim was not completed in line with the 30 November deadline and was signed off on 23 December 2020 due to delays in processing amendments required to the form. We are confident that management have a strong understanding of the actions required in the coming year to ensure this deadline is met for 2020/21.

2020/21

Financial statements

Our formal planning work commenced during March. We have summarised our considerations at this time on page 5. In addition to this we will:

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

Our planning work has started later than last year as a result of the pandemic and we expect to be in a position to be able to issue our audit plan summarising our approach to the significant audit risks at the June meeting of the Committee. Due to the unprecedented circumstances presented by the COVID-19 pandemic, we will be reviewing our establishment of significant risks to ensure these correspond to the arrangements which have been in place in the sector in 2020/21.

We hope to conduct early substantive testing of key areas including all revenue streams, operating expenditure, payroll costs and capital.

We will report any findings from our interim audit in these progress reports received at each meeting of the Audit and Standards Committee.

Value for money

On page 6 we have summarised the refreshed value for money approach for members of the Audit and Standards Committee. We are in the process of requesting information and arranging meetings with key personnel at the Council in order to progress this work.

Financial Statements Audit 2020/21

Materiality

The concept of materiality

Materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Significant risks

Although we have started our planning work we are not at a stage where we can formally confirm the significant risks that we will be auditing. However, the sections below indicate likely areas that we will expect our work to focus on.

Presumed significant risks

ISA (UK) 240 includes two presumed risks as follows:

- Revenue recognition may be misstated due to the improper recognition of revenue. This is a rebuttable risk if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition. We will consider the risk factors set out in ISA240 and the nature of the revenue streams at the Council and Pension Fund to determine whether there is a risk of fraud from revenue recognition. We are cognisant that the Council has been in receipt of additional revenue streams this year and we will be documenting the business processes of these and existing streams as part of our planning procedures to help inform our consideration of the revenue recognition risk.
- The risk of management over-ride of controls is present in all entities. The need to achieve a particular financial outturn could potentially place management under undue pressure in terms of how they report performance.

Other potential significant risks at time of writing

Valuation of land and buildings - The Council revalues its land and buildings on an annual basis to ensure the carrying value in the Council financial statements is not materially different from the current value at the financial statements date. This valuation represents a significant estimate by management in the financial statements due to the value involved and the sensitivity of this estimate to changes in key assumptions. It is expected that the valuation of land and buildings will continue to be identified as a significant risk.

Valuation of net pension liability - The Council's pension fund net liability, as reflected in its balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements. The pension fund net liability is considered a significant estimate due to the size of the numbers involved in the Council's balance sheet and the sensitivity of the estimate to changes in key assumptions. It is expected that the net pension liability will continue to be identified as a significant risk.

Valuation of level 3 investments - The Pension Fund revalues its investments on an annual basis to ensure that the carrying value is not materially different from the fair value at the financial statements date. By their nature Level 3 investment valuations lack observable inputs. These valuations therefore represent a significant estimate by management in the financial statements due to the size of the numbers involved and the sensitivity of this estimate to changes in key assumptions. It is expected that the valuation of level 3 investments will continue to be identified as a significant risk.

Other expected areas of focus

- We set out on pages 8 and 9 detail pertaining to the new accounting standard on Estimates. This raises the bar in terms of what both we and management are required to do. Therefore while in the past, we have focussed on the valuation of property plant and equipment, the net pension liability as well level 3 investments for the pension fund, on the grounds that they are large and complex estimates in the accounts, this will occur to an even greater extent in 2020/21. This will also apply to any other material estimates made by management.
- *Practice Note 10: The application of auditing standards for public sector audits* was updated in November 2020. Revisions to PN 10 in respect of going concern are important and mark a significant departure from how this concept has been audited in the public sector in the past. In particular, PN 10 allows auditors to apply a 'continued provision of service approach' to auditing going concern, where appropriate. We are awaiting further NAO guidance but whilst our consideration of material going concern uncertainties will continue we do not anticipate this being a significant risk in 2020/21.

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 requires 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. As follows:

Improving economy, efficiency and effectiveness

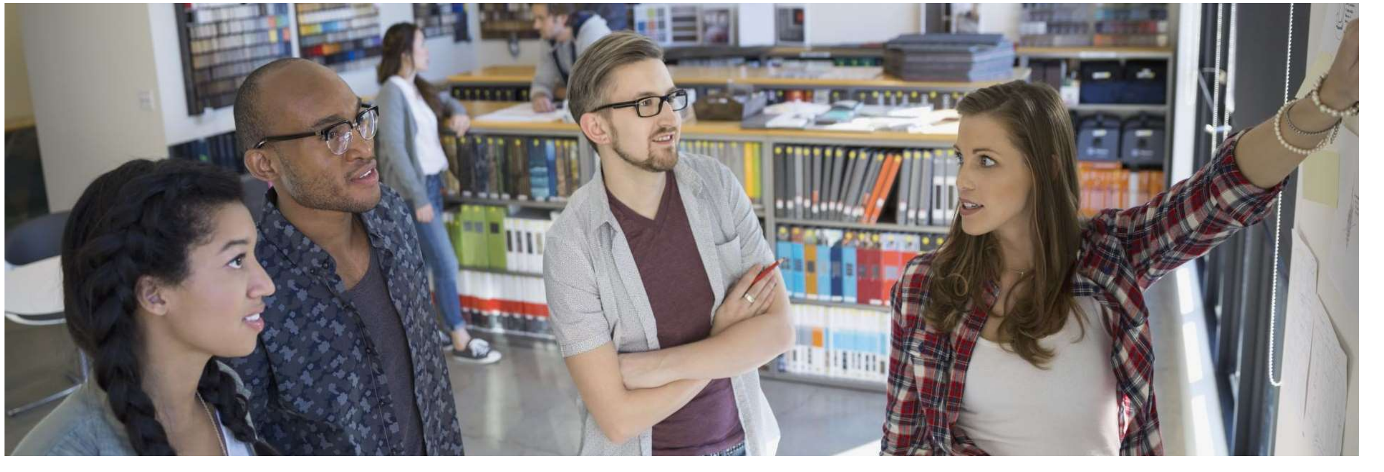
Arrangements for improving the way the body delivers its services. This includes arrangements for understanding costs and delivering efficiencies and improving outcomes for service users.

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



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 need to perform further procedures on. We may need to make recommendations following the completion of our work. The potential different types of recommendations we could make are set out in the table below.

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

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 Council we have identified the following material accounting estimates for which this is likely to apply:

- Valuations of land and buildings and investment properties
- Depreciation
- Year end provisions and accruals
- Credit loss and impairment allowances
- Valuation of defined benefit net pension fund liabilities
- Fair value estimates
- Financial guarantees

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.

Revised auditing standard: Auditing Accounting Estimates and Related Disclosures Cont'd

We are aware that the Council 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 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 (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

Audit Deliverables

2020/21 Deliverables	Planned Date	Status
Fee Letter Outlining the proposed audit fee for 2020-21.	June 2021	Not yet due
Audit Plan We are required to issue a detailed audit plan to the Audit and Standards Committee setting out our proposed approach in order to give an opinion on the Council and Pension Fund's 2020-21 financial statements and a Conclusion on the Council's Value for Money arrangements.	June 2021	Not yet due
Audit Findings Report (AFR) The Audit Findings Report will be reported to the Audit and Standards Committee.	September 2021	Not yet due
Auditor's Report This is the opinion on your financial statement, annual governance statement and value for money conclusion.	September 2021	Not yet due
Auditor's Annual Report This letter communicates the key issues arising from our work. 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 AAR will be published at the same time as the Auditor's Report	September 2021	Not yet due

Your returning Engagement Lead

Engagement Lead – John Gregory, Director (CPFA)

John has built his career around ensuring accountability in public services, having worked for many years at the Audit Commission and then Grant Thornton. He first became an Engagement Lead in 1997, and since that time has been responsible for the external audits of a wide range of local government and NHS bodies right across the Midlands, including county councils, metropolitan and unitary councils (including Birmingham) as well as a wide range of districts, police, fire and pension funds. His portfolio currently includes two other counties – Leicestershire and Nottinghamshire – as well as a range of other councils. In the summer of 2020, he wrote the Report in the Public Interest regarding the failing energy company at Nottingham City Council.

As well as his day-to-day portfolio, John is national lead within Grant Thornton on challenge and legality matters, providing advice to colleagues on handling objections to the accounts and potential exercise of statutory powers. He also leads on ensuring audit quality within the Grant Thornton Midlands public sector team.

John believes in having open relationships with the public bodies he audits, to ensure that potential issues are aired and resolved early, and looks forward to working with Warwickshire County Council once again.

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

New NAO Code of Audit Practice for 2020-21

The NAO issued a new Code of Audit Practice which came into force on 1 April 2020 and applies to audits of 2020-21. The key change is an extension to the framework for VfM work.

The NAO has prepared Auditor Guidance Note (AGN 03), which sets out detailed guidance on what VfM work needs to be performed. Public consultation on this ended
2 September 2020.

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; and
- provide clearer recommendations to help local bodies improve their arrangements.

Under the previous Code, auditors had only to undertake work on VFM where there was a potential significant risk and reporting was by exception. Whereas against the new Code, auditors are required to undertake work to provide a commentary against three criteria set by the NAO – governance; financial sustainability and improving economy, efficiency and effectiveness.

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

Recommendations

Progress in implementing recommendations

Use of additional powers

Opinion on the financial statements

The '**Commentary on arrangements**' 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

The new approach is more complex, more involved and will subsequently increase the cost of audit. We will be discussing this with the Chief Operating Officer shortly.

To review the new Code and AGN03 click here