Audit Plan Update, Progress Report and Sector Update

Walsall 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 local authority.

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 your Engagement Manager.

Changes to your audit team for 2020/21

Richard Percival, your Engagement Lead for 2019/20, and Lorraine Noak, your Engagement Manager, are retiring from Grant Thornton and as a result we are introducing a new Engagement Lead and Manager for 2020/21.

Jon has been a Partner at Grant Thornton for over 14 years and brings considerable experience of working with Local Authorities across the Midlands and South West. He has previously acted as Engagement Lead for Walsall Council and so will already be known to some officers and members.

Andy is new to the Walsall Council audit but has worked in public sector audit in the West Midlands for over 20 years, both with Grant Thornton and previously with the Audit Commission.

Jon and Andy look forward to building a positive relationship with you to ensure the effective and efficient delivery of your 2020/21 audit.

Financial Statements Audit 2019/20

Financial Statements Audit

We issued unqualified audit opinions on the financial statements of the Council on 27 November 2020.

We included an emphasis of matter within our audit opinion which referred to the disclosures that management had made regarding the material uncertainties in the valuations of land and buildings and the pension fund's property investments as at 31 March 2020. Our audit opinion was not modified as a result of this emphasis.

Value for Money opinion

We issued an unqualified value for money opinion for the year ended 31 March 2020 on 27 November 2020.

Certification of Completion of the Audit and Whole of Government Accounts (WGA)

We were unable to certify the completion of the audit for 2019/20 in December 2020 as, at that time we had not been able to issue our assurance statement over the consistency of the Council's WGA submission with the financial statements. This work has been protracted due to technical issues with the central system (OSCAR), which meant the Council were unable to demonstrate that they had made the required changes to their submission.

The technical issues with the central system have now been resolved. We completed our review and submitted our assurance statement confirming that the final submission was consistent with the Council's published financial statements on 16 February 2021.

Following completion of this work we certified completion of the Council's audit on 17 February 2021.

Certification of claims and returns

Housing Benefits

The Department for Work and Pensions (DWP) moved the reporting deadline from 31 November 2020 to 31 January 2021. We were able to sign off and submit our assurance work on the Council's Housing Benefit subsidy claim on 28 January 2021, in accordance with procedures agreed with the DWP.

Our work on the Council's 2019/20 subsidy claim identified no errors or other issues which we were required to the DWP, and we similarly identified no errors or reporting issues in the previous year.

The fee for our assurance work on the 2019/20 subsidy claim was £12,500.

Events

We provide a range of workshops, along with network events for members and publications to support the Council. Your officers were invited to 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
Audit Findings Report	September 2020	November 2020
Auditors Report	September 2020	December 2020
Annual Audit Letter	October 2020	March 2021 (within one month of audit completion)

2020/21 Deliverables		
Audit Plan	March 2021	Update included in this progress report
Audit opinion	September 2021	Not yet due
Audit Annual Report	September 2021	Not yet due

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.

We have determined materiality for planning purposes as £10.115m, which is 1.5% of gross expenditure for the prior year.

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 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 to determine whether there is a risk of fraud from revenue recognition. We were able to rebut this risk in 2019/20, but 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.
- In the public sector, we also consider whether expenditure recognition may be misstated due to the improper recognition of expenditure. We can rebut this risk if we conclude that there is no risk of material misstatement. We were able to rebut this risk in 2019/20, and will consider the impact of additional expenditure arising due to covid-19 in 2020/21 as part of our consideration of the expenditure 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

Implementation of new general ledger – We are aware that the Council has implemented a new financial ledger in 2020/21, with the move to Oracle Fusion going live from July 2020, including the Finance and Procurement modules. The upgraded Payroll module is due to go live from July 2021. The changes to the general ledger potentially represents a significant change to the accounting systems and processes in place for 2020/21 and as such has been identified as a significant risk.

Valuation of land and buildings - The Council revalues its land and buildings and council dwellings on a rolling basis. To ensure the carrying value in the Council financial statements is not materially different from the current value at the financial statements date, the Council requests valuations from its internal and external valuation experts. This valuation represents a significant estimate by management in the financial statements due to the value involved (£464.187 million in the Council's balance sheet as at 31 March 2020) and the sensitivity of this estimate to changes in key assumptions. It is expected that the valuation of land and buildings and council dwellings 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 (£572m in the Council's balance sheet as at 31 March 2020) 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 investments – The Council holds material investments, which includes investments held at fair value (£42.7m at 31 March 2020). Valuation of these investments is subject to a high degree of judgement and as such the valuation of these investments is considered to be a significant estimate by management in the financial statements. For 2020/21 we consider that the valuation of investments will be identified as a significant risk.

Financial Statements Audit 2020/21

Other expected areas of focus

- We set out on pages 11 and 12 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, as well as the net pension liability, 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.
- We are aware that the Council has a highly material capital programme, and an area of increased focus for auditors in recent years has been around the classifications made by councils between capital and revenue expenditure. We are not aware of any particular issues arising in this area for Walsall Council, and understand that regular reviews and controls are in place to ensure the correct classification of capital expenditure, however given the materiality of the figures in 2020/21 we anticipate that this will feature as a particular area of audit focus.

The Accounts and Audit (Amendment) Regulations 2021

The Accounts and Audit (Amendment) Regulations 2021 were laid before parliament on 9 March 2021 and come in to force on 31 March 2021. The regulations amend the draft accounts publication deadline to 31 July, and the final accounts publication deadlines to 30 September, for both the 2020/21 and 2021/22 accounting years. The regulations also include a new requirement for all local bodies to post a notice on their website if they fail to publish their draft accounts by 1 August 2021.

We understand that Walsall Council still intend to publish draft 2020/21 accounts by 1 June as was required under the previous regulations. We will work with Council officers to agree a timescale for completion of the 2020/21 audit.

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 below:

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.

At this stage we anticipate that risks are likely to relate to:

Financial sustainability – delivery of the PROUD programme, savings and financial plans

Improving Economy, Efficiency and Effectiveness – working in partnership to delivery strategic priorities.

We may need to make recommendations following the completion of our work. The potential different types of recommendations we could make are set out below.

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 and Risk 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
- 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. investments and 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 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 uncertainly 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 and Risk 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

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.

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

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.

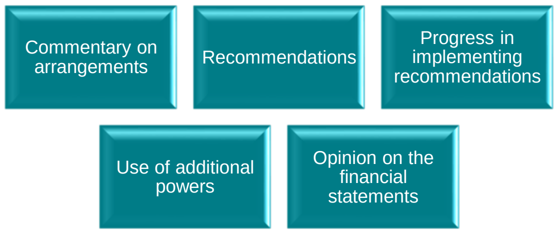
The NAO has prepared Auditor Guidance Note (AGN 03), which sets out detailed guidance on what VfM work needs to be performed. Public consultation on this ended 2 September 2020.

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:



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

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