

AUDIT UPDATE

Introduction

1. This report provides the Committee with an update from Grant Thornton on changes to the Audit Plan presented to the March Committee meeting due to Covid-19.

Recommendation

2. The Committee are asked to:
 - Note and provide any comment on the update to the Audit Plan ahead of it being presented to Audit and Governance Committee, and
 - Note and comment on the Progress Update from Grant Thornton.

Audit Plan

3. The Audit Plan was presented to Committee 13 March 2020. Following this meeting the impact of Covid-19 has led to the external auditors revising the plan.
4. Appendix A to this report provides the revision to the Audit Plan which identifies Covid-19 as a significant audit risk area requiring special audit consideration this year. Page 3 of the plan details the reason why Covid-19 has been added as a significant audit risk and the auditor's proposed response.

Interim Audit Progress Report

5. Appendix B to the report is the Progress Report from Grant Thornton which provides the Committee with the further update following the March Committee meeting.
6. The report sets out the impact of Covid-19 on the Statement of Accounts and Audit along with the changes to working practices and the timetable as detailed in Item 4.
7. The report also includes the results of the Interim Audit which took place late March/early April along with a general update from the Audit Sector.



External Audit Plan Update

Cheshire Pension Fund

Year ending 31 March 2020

20 May 2020



Introduction & headlines

Purpose

This document provides an update to the planned scope and timing of the statutory audit of Cheshire Pension Fund ('the Fund') as reported in our Audit Plan dated March 2020, for those charged with governance.

The current environment

In addition to the audit risks communicated to those charged with governance in our Audit Plan dated March 2020, recent events have led us to update our planning risk assessment and reconsider our audit approach to reflect the unprecedented global response to the Covid-19 pandemic. The significance of the situation cannot be underestimated and the implications for individuals, organisations and communities remains highly uncertain. For our public sector audited bodies, we appreciate the significant responsibility and burden your staff have to ensure vital public services are provided. The Fund will also be specifically facing a number of tough challenges around covenant strengths, funding, investment, governance and communications to members. As far we can, our aim is to work with you in these unprecedented times, ensuring up to date communication and flexibility where possible in our audit procedures.

Impact on our audit

Management and those charged with governance are still required to prepare financial statements in accordance with the relevant accounting standards and the Code of Audit Practice, albeit to an extended deadline for the preparation of the financial statements up to 31 August 2020 and the date for audited financial statements to 30 November 2020. We understand that the Fund is aiming to share with us draft financial statements by 31 May 2020 and we will liaise with management should changes to our agreed delivery timescales be necessary. We continue to be responsible for forming and expressing an opinion on the Fund's financial statements.

In order to fulfil our responsibilities under International Auditing Standards (ISA's (UK)) we have revisited our planning risk assessment. We may also need to consider implementing changes to the procedures we had planned and reported in our Audit Plan to reflect current restrictions to working practices, such as the application of technology to allow remote working. Additionally, it has been confirmed since our Audit Plan was issued that the implementation of IFRS 16 has been delayed for the public sector until 2021/22 – we expect the impact of IFRS 16 on the Fund to be minimal.

Changes to our audit approach

To date we have:

- Identified a new significant financial statement risk, as described overleaf
- Reviewed the materiality levels we determined for the audit. We did not identify any changes to our materiality assessment as a result of the specific risk identified due to Covid-19 at this time but we will keep matters under review (see next bullet)
- We anticipate revisiting headline materiality - which is determined at the planning stage using net assets as a benchmark and is currently £56.038 as reported in our Audit Plan dated March 2020 - due to the volatility observed in global markets in the first quarter of 2020. We will not be able to confirm any revised value (if appropriate) until we have received draft financial statements owing to the high level of uncertainty. In the event that materiality is revised we will communicate this to those charged with governance and confirm within our Audit Findings Report

Conclusion

We will ensure any further changes in our audit approach and procedures are communicated with management and reported in our Audit Findings Report. We wish to thank management for their timely collaboration in this difficult time.

Significant risk identified – COVID-19 pandemic

Significant risks are defined by ISAs (UK) as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement.

Risk	Reason for risk identification	Key aspects of our proposed response to the risk
<p>Covid-19</p>	<p>The global outbreak of the Covid-19 virus pandemic has led to unprecedented uncertainty for all organisations, requiring urgent business continuity arrangements to be implemented. We expect current circumstances will have an impact on the production and audit of the financial statements for the year ended 31 March 2020, including and not limited to;</p> <ul style="list-style-type: none"> • Remote working arrangements and redeployment of staff to critical front line duties may impact on the quality and timing of the production of the financial statements, and the evidence we can obtain through physical observation • Volatility of financial and property markets will increase the uncertainty of assumptions applied by management to asset valuation, and the reliability of evidence we can obtain to corroborate management estimates • For instruments classified as fair value through profit and loss there may be a need to review the Level 1-3 classification of the instruments if trading may have reduced to such an extent that quoted prices are not readily and regularly available and therefore do not represent actual and regularly occurring market transactions • Whilst the nature of the Fund and its funding position (i.e. not in a winding up position or no cessation event) means the going concern basis of preparation remains appropriate management may need to consider whether material uncertainties for a period of at least 12 months from the anticipated date of approval of the audited financial statements have arisen; and • Disclosures within the financial statements will require significant revision to reflect the unprecedented situation and its impact on the preparation of the financial statements as at 31 March 2020 in accordance with IAS1, particularly in relation to material uncertainties <p>We therefore identified the global outbreak of the Covid-19 virus as a significant risk, which was one of the most significant assessed risks of material misstatement.</p>	<p>We will:</p> <ul style="list-style-type: none"> • Work with management to understand the implications the response to the Covid-19 pandemic has on the organisation's ability to prepare the financial statements and update financial forecasts and assess the implications on our audit approach • Liaise with other audit suppliers, regulators and government departments to co-ordinate practical cross sector responses to issues as and when they arise • Evaluate the adequacy of the disclosures in the financial statements in light of the Covid-19 pandemic. Including management's assessment of the impact of Covid-19 upon employer covenants and forecast cashflows • Evaluate whether sufficient audit evidence using alternative approaches can be obtained for the purposes of our audit whilst working remotely • Evaluate whether sufficient audit evidence can be obtained to corroborate management's fair value hierarchy disclosure • Evaluate whether sufficient audit evidence can be obtained to corroborate significant management estimates such as Level 3 asset valuations, including direct property - dependent on the level of volatility, we may need the assistance of our own internal valuation expert to obtain the required assurance • Discuss with management any potential implications for our audit report if we have been unable to obtain sufficient audit evidence

The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect your business or any weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.



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Audit Progress Report and Sector Update

Cheshire Pension Fund
Year ending 31 March 2020

20 May 2020



Contents

Section	Page
Introduction	3
Progress at May 2020	4
Audit Deliverables	6
Results of Interim Audit Work	7
Sector Update	9

Introduction



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This paper provides the Pension Fund 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 Government Pension Fund.

Members of the Pension Fund 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 December, and we began our interim audit in March 2020. Our interim fieldwork includes:

- Updated review of the Fund's control environment
- Updated understanding of financial systems
- Review of any Internal Audit reports on core financial systems
- Early work on emerging accounting issues
- Early substantive testing including IAS 19 and Triennial Valuation testing

The results of our work to date are included in this report.

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, in line with the revised national deadline.

Other areas

Meetings

We met with Finance Officers throughout the interim audit and as part of our quarterly liaison meetings and continue to be in discussions with finance staff regarding emerging developments and to ensure the audit process is smooth and effective.

Audit Fees

During 2017, PSAA awarded contracts for audit for a five year period beginning on 1 April 2018. 2019/20 is the second year of that contract. Since that time, there have been a number of developments within the accounting and audit profession. Across all sectors and firms, the Financial Reporting Council (FRC) has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge and to undertake additional and more robust testing.

Our work in the Local Government sector in 2018/19 has highlighted areas where financial reporting, in particular, property, plant and equipment (including direct property valuations), needs to improve. There is also an increase in the complexity of Local Government financial transactions and financial reporting. This combined with the FRC requirement that all Local Government audits are at or above the "few improvements needed" (2A) rating means that additional audit work is required.

We have reviewed the impact of these changes on both the cost and timing of audits. We have discussed this with your Finance & Investments Manager including any proposed variations to the Scale Fee set by PSAA Limited, and have communicated fully with the Pension Fund and Audit & Governance Committees.

As a firm, we are absolutely committed to meeting the expectations of the FRC with regard to audit quality and local government financial reporting.

COVID-19 Update

Impact on working arrangements:

- following the government's announcement on Monday 16th March, we have closed our Grant Thornton 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.

- Valuation of directly held property and assumptions made by valuers, particularly in respect of fair value
- 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 reporting to those charged with governance and signing arrangements

Changes to Local Government deadlines and requirements:

- draft accounts deadline to be moved from 1 June to 31 August.
- audited accounts deadline moved from 31 July to 30 November.
- IFRS 16 implementation has been delayed by 1 year to 1 April 2021.
- 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.

Audit Deliverables

2019/20 Deliverables	Planned Date	Status
<p>Audit Plan</p> <p>We issue a detailed audit plan to the Pension Fund Committee and Audit & Governance Committee setting out our proposed approach in order to give an opinion on the Fund's 2019-20 financial statements.</p>	March 2020	Complete
<p>Interim Audit Findings</p> <p>We will report to you the findings from our interim within our Progress Report.</p>	June 2020	Within this report
<p>Audit Findings Report</p> <p>The Audit Findings Report will be reported to the September Pension Fund Committee.</p>	September 2020	Not yet due
<p>Auditors Report</p> <p>This is the opinion on your financial statements and consistency opinion. The planned date is the date we are aiming for sign off. The final sign off date is reliant on the Cheshire West & Chester Council audit sign off date.</p>	September 2020	Not yet due

Results of Interim Audit Work

The findings of our interim audit work, and the impact of our findings on the accounts audit approach, are summarised in the table below:

	Work performed	Conclusions and recommendations
Internal audit	<p>We have completed a high level review of internal audit's overall arrangements. Our work has not identified any issues which we wish to bring to your attention.</p> <p>We have also reviewed internal audit's work on the Fund's key financial systems to date. We have not identified any significant weaknesses impacting on our responsibilities.</p>	Our review of internal audit work has not identified any weaknesses which impact on our audit approach.
Entity level controls	<p>We have obtained an understanding of the overall control environment relevant to the preparation of the financial statements including:</p> <ul style="list-style-type: none"> • Communication and enforcement of integrity and ethical values • Commitment to competence • Participation by those charged with governance • Management's philosophy and operating style • Organisational structure • Assignment of authority and responsibility • Human resource policies and practices 	Our work has identified no material weaknesses which are likely to adversely impact on the Fund's financial statements.
Assurance Letters from management and those charged with governance	<p>As part of our planning work to understand the Fund's governance arrangements, we have raised a number of questions to management and those charged with governance.</p> <p>The questions deal with a variety of issues such as internal control, risk management, fraud and litigation, and the potential impact of these areas on the Fund's annual accounts.</p>	The letters have been shared with management and those charged with governance. We have received the management response and await the response from the Audit and Governance Committee.

	Work performed	Conclusions and recommendations
Review of information technology controls	<p>We performed a high level review of the general IT control environment, as part of the overall review of the internal controls system.</p> <p>IT (information technology) controls were observed to have been implemented in accordance with our documented understanding.</p> <p>We are still awaiting the work of our IT specialist who is reviewing the Oracle system as part of their work for Cheshire West & Chester Council.</p>	<p>Our work to date has identified no material weaknesses which are likely to adversely impact on the Fund's financial statements.</p>
Walkthrough testing	<p>We have completed walkthrough tests of the Fund's controls operating in areas where we consider that there is a significant risk of material misstatement to the financial statements.</p> <p>Our work has not identified any issues which we wish to bring to your attention. Internal controls have been implemented by the Fund in accordance with our documented understanding.</p>	<p>Our work has not identified any weaknesses which impact on our audit approach.</p>
Journal entry controls	<p>We have reviewed the Fund's journal entry policies and procedures as part of determining our journal entry testing strategy and have not identified any material weaknesses which are likely to adversely impact on the Fund's control environment or financial statements.</p>	<p>Our work has not identified any weaknesses which impact on our audit approach. We will undertake further testing of journals during our final accounts visit.</p>
Valuation of directly held property	<p>We have held discussions with your finance team regarding the valuation process for the Fund's directly held property assets for the 2019-20 financial statements.</p> <p>The Fund needs to consider in light of the emerging situation around Coronavirus, whether there is any impact on valuation of its directly held investment property. There is a possibility that market indices and asset values may have moved during the last quarter, with a risk that we will see a contraction in the wider economy. Based on this, there may be some impact on inputs used to calculate year end land and building valuations.</p> <p>We will require the Fund to demonstrate that the valuation remains materially accurate at the year end.</p>	<p>We will continue our discussions with officers and will review the assessment carried out by the valuer and the information used to support it.</p> <p>As a significant risk area detailed in our Audit Plan we will report our findings on our work in this area in the Audit Findings Report in September.</p>
IAS 19 Assurance Letters	<p>We have begun our procedures which are required for us to give assurance to auditors of the Fund's admitted employer members over the IAS 19 figures in the employer's accounts.</p> <p>Our work covers assurance over the data submitted to the actuary, testing over the Fund's Investments and assurance over the 2019 triennial valuation process.</p>	<p>Our work in this area is ongoing with letters being submitted to employer auditor in line with the relevant accounts deadlines for each sector.</p>

Sector Update

Local government organisations 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>

MHCLG – Independent probe into local government audit

In July 2019, the then Communities secretary, James Brokenshire, announced the government is to examine local authority financial reporting and auditing.

At the CIPFA conference he told delegates the independent review will be headed up by Sir Tony Redmond, a former CIPFA president.

The government was “working towards improving its approach to local government oversight and support”, Brokenshire promised.

“A robust local audit system is absolutely pivotal to work on oversight, not just because it reinforces confidence in financial reporting but because it reinforces service delivery and, ultimately, our faith in local democracy,” he said.

“There are potentially far-reaching consequences when audits aren’t carried out properly and fail to detect significant problems.”

The review will look at the quality of local authority audits and whether they are highlighting when an organisation is in financial trouble early enough.

It will also look at whether the public has lost faith in auditors and whether the current audit arrangements for councils are still “fit for purpose”.

On the appointment of Redmond, CIPFA chief executive Rob Whiteman said: “Tony Redmond is uniquely placed to lead this vital review, which will be critical for determining future regulatory requirements.

“Local audit is crucial in providing assurance and accountability to the public, while helping to prevent financial and governance failure.”

He added: “This work will allow us to identify what is needed to make local audit as robust as possible, and how the audit function can meet the assurance needs, both now and in the future, of the sector as a whole.”



In the question and answer session following his speech, Brokenshire said he was not looking to bring back the Audit Commission, which appointed auditors to local bodies and was abolished in 2015. MHCLG note that auditing of local authorities was then taken over by the private, voluntary and not-for-profit sectors.

He explained he was “open minded”, but believed the Audit Commission was “of its time”.

Local authorities in England are responsible for 22% of total UK public sector expenditure so their accounts “must be of the highest level of transparency and quality”, the Ministry of Housing, Local Government and Communities said. The review will also look at how local authorities publish their annual accounts and if the financial reporting system is robust enough.

Redmond, who has also been a local authority treasurer and chief executive, was expected to report to the communities secretary with his initial recommendations in December 2019, with a final report published in March 2020. Redmond has also worked as a local government boundary commissioner and held the post of local government ombudsman.

The terms of reference focus on whether there is an “expectation gap” between the purpose of external audit and what it is currently delivering. It will examine the performance of local authority audit, judged according to the criteria of economy, effectiveness and efficiency.

Other key areas of the review include whether:

- 1) audit recommendations are effective in helping councils to improve financial management
- 2) auditors are using their reporting powers appropriately
- 3) councils are responding to auditors appropriately
- 4) Financial savings from local audit reforms have been realised
- 5) There has been an increase in audit providers
- 6) Auditors are properly responding to questions or objections by local taxpayers
- 7) Council accounts report financial performance in a way that is transparent and open to local press scrutiny

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.

Financial Reporting Council – Summary of key developments for 2019/20 annual reports

On 30 October the Financial Reporting Council (FRC) wrote an Open Letter to Company Audit Committee Chairs. Some of the points are relevant to local authorities.

The reporting environment

The FRC notes that, “In times of uncertainty, whether created by political events, general economic conditions or operational challenges, investors look for greater transparency in corporate reports to inform their decision-making. We expect companies to consider carefully the detail provided in those areas of their reports which are exposed to heightened levels of risk; for example, descriptions of how they have approached going concern considerations, the impact of Brexit and all areas of material estimation uncertainty.” These issues equally affect local authorities, and the Statement of Accounts or Annual Report should provide readers with sufficient appropriate information on these topics.

Critical judgements and estimates

The FRC wrote “More companies this year made a clear distinction between the critical judgements they make in preparing their accounts from those that involve the making of estimates and which lead to different disclosure requirements. However, some provided insufficient disclosures to explain this area of their reporting where a particular judgement had significant impact on their reporting; for example, whether a specific investment was a joint venture or a subsidiary requiring consolidation. We will continue to have a key focus on the adequacy of disclosures supporting transparent reporting of estimation uncertainties. An understanding of their sensitivity to changing assumptions is of critical value to investors, giving them clearer insight into the possible future changes in balance sheet values and which can inform their investment decisions.” Critical judgements and estimates also form a crucial part of local authority statements of account, with the distinction often blurred.

For Local Government Pension Funds this will mean additional work in complex areas of the accounts with high estimation uncertainty, such as directly held property and level 3 investments. As part of audit we will be demonstrating increased challenge over the assumptions, inputs and calculations used in the valuation of these assets.



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 entity’s business model and strategy; the business risks it faces; and the perception of the reasonable expectations of 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 entity. 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>

What is the future for local audit?

Paul Dossett, Head of local government at Grant Thornton, has written in the Municipal Journal “Audit has been a hot topic of debate this year and local audit is no exception. With a review into the quality of local audit now ongoing, it’s critical that part of this work looks at the overarching governance and management of the audit regime. We believe there is a strong need for new oversight arrangements if the local audit regime is to remain sustainable and effective in the future.”

Paul goes on to write “Local (local authority and NHS) audit has been a key part of the oversight regime for public services for more than a century. The National Audit Office (NAO) has exercised this role in central government for several generations and their reporting to Parliament via the Public Accounts Committee is a key part of the public spending accountability framework.

Local audit got a significant boost with the creation of the Audit Commission in 1983 which provided a coordinated, high profile focus on local government and (from 1990) NHS spending and performance at a local level. Through undertaking value for money reviews and maintaining a tight focus on the generational governance challenges, such as rate capping in the 1980s and service governance failings in the 1990s, the Commission provided a robust market management function for the local audit regime. Local audit fees, appointments, scope, quality and relevant support for auditors all fell within their ambit.

However, the Commission was ultimately deemed, among other things, to be too expensive and was abolished in 2010, as part of the Coalition Government’s austerity saving plans. While the regime was not perfect, and the sector had acknowledged that reform of the Commission was needed, complete abolition was not the answer.

Since then, there has been no body with complete oversight of the local audit regime and how it interacts with local public services. The Ministry of Housing, Communities and Local Government; Department of Health; NHS; NAO; Local Government Association (LGA); Public Sector Audit Appointments Ltd (PSAA); the Financial Reporting Council (FRC); the Chartered Institute of Public Finance & Accountancy (CIPFA), audit firms and the audited bodies themselves all have an important role to play but, sometimes, the pursuit of individual organisational objectives has resulted in sub-optimal and even conflicting outcomes for the regime overall.

These various bodies have pursued separate objectives in areas such as audit fee reduction, scope of work, compliance with commercial practice, earlier reporting deadlines and mirroring commercial accounting conventions – to name just a few.

This has resulted in a regime that no stakeholder is wholly satisfied with and one that does not ensure local audit is providing a sufficiently robust and holistic oversight of public spending.

To help provide a more cohesive and co-ordinated approach within the sector, we believe that new oversight arrangements should be introduced. These would have ultimate responsibility for ensuring the sustainability of the local audit regime and that its component parts – including the Audit Code, regulation, market management and fees – interact in an optimal way. While these arrangements do not need to be another Audit Commission, we need to have a strategic approach to addressing the financial sustainability challenges facing local government and the NHS, the benchmarking of performance and the investigation of governance failings.

There are a number of possible solutions including:

- 1) The creation of a new arm’s length agency with a specific remit for overseeing and joining up local audit. It would provide a framework to ensure the sustainability of the regime, covering fees, appointments, and audit quality. The body would also help to create a consistent voice to government and relevant public sector stakeholders on key issues arising from the regime. Such a body would need its own governance structure drawn from the public sector and wider business community; and
- 2) Extending the current remit of the NAO. Give it total oversight of the local audit regime and, in effect, establish a local audit version of the NAO, with all the attendant powers exercised in respect of local audit. In this context, there would be a need to create appropriate governance for the various sectors, similar to the Public Accounts Committee.

While the detail of the new arrangements would be up for debate, it’s clear that a new type of oversight body, with ultimate responsibility for the key elements of local audit, is needed. It would help to provide much-needed cohesion across the sector and between its core stakeholders.

The online article is available here:

<https://www.themj.co.uk/What-is-the-future-for-audit/214769>

