

Audit Committee Progress Report – February 2020

Lincolnshire County Council
Lincolnshire Pension Fund
Year ending 31 March 2020





CONTENTS

1. Summary

2. Audit Progress

Appendix 1 – Communications and Timeline

Appendix 2 – CIPFA 2019/20 Year end Bulletin

1. SUMMARY

Purpose of this report

This report provides the Audit Committee at its June 2020 meeting with an update on progress in delivering our responsibilities as your external auditor for Lincolnshire County Council and the Lincolnshire County Pension Fund.

The County Council and Pension Fund 2019/20 Audit Strategy Memoranda were issued ahead of the planned March 2020 Audit Committee and are included now on the agenda for this meeting. This report provides updates to those documents where necessary.

Financial Statements Audits

The changes to working arrangements during the COVID-19 'lock-down' period and other pressures in the local government sector has led to a number of changes to the audit approaches and matters outlined in the Audit Strategy Memoranda.

- Remote working - Mazars moved to working remotely on 16 March 2020. So far these arrangements have worked reasonably well at our clients and the systems in place for sharing information between clients and ourselves have operated as expected. We expect to need to continue to operate on this remote basis throughout the upcoming audits and for the near future, including the reporting and closure stages of the audit. We will continue to work with management to deal with any practical difficulties in delivering the audit as the work progresses.
- Timetable changes – there have been significant changes to the statutory timetable for the 2019/20 accounts preparation and publication. The statutory deadlines for the publication of the draft and audited financial statements have been changed to 31 August (from 31 May) and 30 November (from 31 July) respectively. We have agreed with management changes to the scheduling of our work to accommodate the new timetable. The majority of the audit work will now take place in July and August, based on the draft financial Statements produced by 30 June. We plan to submit our Audit Completion Reports to the September Audit Committee meeting and issue the Auditor's Report before the end of September. This timetable is dependent on a number of factors and we will update to Audit Committee if any changes are required.
- Financial Reporting Issues – a number of key financial reporting issues as a result of the COVID-19 pandemic have emerged over recent weeks. CIPFA's Bulletin 05 on the Closure of the 2019/20 Financial Statements summarises the key points to consider and we have included a summary of the Bulletin at Appendix 2 to this report. We have discussed with management the local position on these issues and other COVID-19 related matters and are taking them into account in our detailed audit work.

We have included at Section 2 of this report a summary of the current position on the audit risks and other reporting requirements set out in our 2019/20 Audit Strategy Memoranda. We will report further on these matters in our Audit Completion Reports to the Audit Committee in June 2020. We have included an updated Communications and Timeline summary at Appendix 1.

Value for Money Conclusion

In our Lincolnshire County Council Audit Strategy Memorandum we reported that we had not identified any significant risks to our 2019/20 VFM conclusion. We keep our assessment up to date and before concluding on the work take into account any matters which come to our attention through the course of our audit which may affect our reporting. Our Audit Strategy Memorandum sets out the sources of information we consider. We have not to date identified any matters in those areas which indicate any additional significant VFM risks or that we will be unable to give an unqualified VFM conclusion. NAO's updated guidance clarifies that auditors should generally consider local bodies' arrangements and their response to the COVID-19 pandemic as part of their 2020/21 work on VFM arrangements. Only where there is a clear indication of a significant failure of arrangements during the 2019/20 as a result of COVID-19 would it be appropriate to raise a 2019/20 significant VFM risk. We have not identified any significant failures in the Council's arrangements during 2019/20 and are satisfied that no additional significant VFM risks have been identified.

2. AUDIT PROGRESS

This section includes a summary of the key matters reported in the 2019/20 Audit Strategy Memorandum for the County Council and the Pension Fund and updates based on the audit work carried out to date. We will report the final position on this matters in our Audit Completion Reports to the September Audit Committee.

Significant Audit Risks – Lincolnshire County Council

	Description of risk	Planned response	Update June 2020
1	<p>Management override of controls</p> <p>Management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur there is a risk of material misstatement due to fraud on all audits.</p>	<p>We plan to address the management override of controls risk through performing audit work over accounting estimates, journal entries and significant transactions outside the normal course of business or otherwise unusual.</p>	<p>No significant findings from the audit work carried out to date that we need to report to the Audit Committee at this stage.</p>
2	<p>Expenditure recognition</p> <p>Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council (FRC), which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition</p> <p>Having considered the factors for expenditure recognition, we believe the risk is focused on the year-end balance sheet and in particular the completeness and valuation of payables, specifically those that are material and manually accrued.</p>	<p>We will evaluate the design and implementation of controls to mitigate the risk of material manual accruals being recognised in the wrong period. In addition, we will test such accruals to ensure that they are supported by sufficient and appropriate evidence and have been accounted for correctly.</p> <p>Our audit approach will also incorporate a range of other substantive procedures, including:</p> <ul style="list-style-type: none"> • testing of payments around the year-end to provide assurance that there are no material unrecorded items of income and expenditure in the 2019/20 accounts; and • testing journals. 	<p>No significant findings from the audit work carried out to date that we need to report to the Audit Committee at this stage.</p>

2. AUDIT PROGRESS (CONT.)

Significant Audit Risks – Lincolnshire County Council

	Description of risk	Planned response	Update June 2020
3	<p>Revenue recognition</p> <p>Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. Having considered the factors for revenue recognition, we believe the risk is focused on the year-end balance sheet and in particular the existence and accuracy of receivables, specifically those that are material, subject to manual intervention and / or significant estimation.</p>	<p>We will evaluate the design and implementation of controls to mitigate the risk of material manual receivables being recognised in the wrong period. In addition, we will test such receivables to ensure that they are supported by sufficient and appropriate evidence and have been accounted for correctly.</p> <p>Our audit approach will also incorporate a range of other substantive procedures, including:</p> <ul style="list-style-type: none"> • testing of receipts around the year-end to provide assurance that there are no material unrecorded items of income and expenditure in the 2019/20 accounts; and • testing journals. 	<p>No significant findings from the audit work carried out to date that we need to report to the Audit Committee at this stage.</p>
4	<p>Valuation of Land and Buildings</p> <p>The Council's accounts contain material balances and disclosures relating to its holding of property, plant and equipment, investment properties and assets held for sale, with the majority of land and building assets required to be carried at valuation. Due to high degree of estimation uncertainty associated with those held at valuation, we have determined there is a significant risk in this area.</p>	<p>We will:</p> <ul style="list-style-type: none"> • Critically assess the Council's valuers' scope of work, qualifications, objectivity and independence to carry out the required programme of revaluations; • Consider whether the overall revaluation methodologies used by the Council's valuers' are in line with industry practice, the CIPFA Code of Practice and the Council's accounting policies; • Assess whether valuation movements are in line with market expectations; • Critically assess the treatment of the upward and downward revaluations in the Council's financial statements; and • Critically assess the approach that the Council adopts to ensure that assets not subject to revaluation in 2019/20 are materially correct. 	<p>We have updated the scope of our work under this risk to reflect the uncertainty over the year-end land and buildings valuations caused by the impact of COVID-19 on market values and building cost indices. We will also consider engaging our own expert valuer to advise on the valuation approaches followed and the reasonableness of the Council's year-end valuations.</p> <p>There are no specific significant findings from the audit work carried out to date that we need to report to the Audit Committee at this stage.</p>

2. AUDIT PROGRESS (CONT.)

Significant Audit Risks – Lincolnshire County Council

	Description of risk	Planned response	Update June 2020
5	<p>Valuation of net defined benefit liability</p> <p>The Council's accounts contain material liabilities relating to the local government pension scheme. The Council uses an actuary to provide an annual valuation of these liabilities in line with the requirements of IAS 19 Employee Benefits. Due to the high degree of estimation uncertainty associated with this valuation, we have determined there is a significant risk in this area.</p>	<p>We will:</p> <ul style="list-style-type: none"> • Critically assess the competency, objectivity and independence of the Lincolnshire Pension Fund's Actuary, Hymans Robertson; • Liaise with the auditors of the Pension Fund to gain assurance that the controls in place at the Pension Fund are operating effectively. This will include the processes and controls in place to ensure data provided to the Actuary by the Pension Fund for the purposes of the IAS 19 valuation is complete and accurate; • Review the appropriateness of the Pension Asset and Liability valuation methodologies applied by the Pension Fund Actuary, and the key assumptions included within the valuation. This will include comparing them to expected ranges, utilising information provided by PWC, the consulting actuary engaged by the National Audit Office; and • Agree the data in the IAS 19 valuation report provided by the Fund Actuary for accounting purposes to the pension accounting entries and disclosures in the Council's financial statements. 	<p>We have updated the scope of our work under this risk to reflect the uncertainty over the year-end pension fund investment asset valuations caused by the impact of COVID-19 on market values.</p> <p>There are no specific significant findings from the audit work carried out to date that we need to report to the Audit Committee at this stage.</p>

2. AUDIT PROGRESS (CONT.)

Significant Audit Risks – Lincolnshire Pension Fund

	Description of risk	Planned response	Update June 2020
1	<p>Management override of controls</p> <p>Management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur there is a risk of material misstatement due to fraud on all audits.</p>	<p>We will address the risk through performing audit procedures, covering a range of areas including (but not limited to):</p> <ul style="list-style-type: none"> • accounting estimates included in the financial statements for evidence of management bias; • any significant transactions outside the normal course of business; and • journals and other adjustments recorded in the general ledger in preparing the financial statements. 	<p>No significant findings from the audit work carried out to date that we need to report to the Audit Committee at this stage.</p>
2	<p>Valuation of unquoted Investments</p> <p>At 31 December 2019 the Pension Fund held investments which were not quoted on an active market with a fair value of £346m, accounting for 13.6 per cent of the Fund's net investment assets.</p> <p>As the pricing of these investment assets is subject to judgements, they may be susceptible to pricing variances due to the assumptions underlying the valuation. We therefore consider that there is an increased risk of material misstatement.</p>	<p>We plan to address this risk by completing the following additional procedures:</p> <ul style="list-style-type: none"> • agree holdings from fund manager reports to the custodian's report; • agree the valuation to supporting documentation including investment manager valuation statements and cashflows for any adjustments made to the investment manager valuation; • agree the investment manager valuation to audited accounts or other independent supporting documentation, where available; and • review independent control assurance reports to identify any exceptions that could present a risk of material misstatement in the Fund's financial statements. 	<p>CIPFA's Bulletin 05 on the Closure of the 2019/20 Financial Statements (see summary at Appendix 1) highlights specific matters relevant to the fair value measurement of pension fund assets given the increased volatility in the markets resulting from the COVID-19 pandemic. The Bulletin highlights the increased estimation uncertainty around investment asset valuations. We are liaising with management on these issues and are taking them into account in our detailed audit work. At this stage we have not engaged our own expert for the valuation of unquoted investments. However we may engage an expert if considered necessary to support the valuation of unusual or complex investments.</p>

2. AUDIT PROGRESS (CONT.)

Materiality

Our Audit Strategy Memoranda set out our planning materiality assessments for 2019/20. These are based on the audited 2018/19 financial statements and the forecast position for 2019/20 at December 2019. We will update these assessments to reflect the 2019/20 draft statements and expect the levels set for the Pension Fund to change given the fall in the relevant benchmark (investment asset values) at 31 March 2020. We will report the updated materiality levels and any audit differences in our Audit Completion Report.

Other Reporting Matters

We have no issues to report at this stage in relation to the following audit matters:

- Fraud
- Significant internal control deficiencies
- Accounting practices
- Non-compliance with laws and regulations
- Practical difficulties in carrying out the audit or co-operation from management
- Threats to our independence

APPENDIX 1 – COMMUNICATIONS AND TIMELINE

ISA (UK) 260 'Communication with Those Charged with Governance', ISA (UK) 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' and other ISAs (UK) specify the matters we are required to communicate to you. These matters, and the reports we will issue, are as follows:

Required communication	Audit Strategy Memorandum	Audit Completion Report
	Separate reports for the Council and the Pension Fund – deferred from to March to June 2020 Audit Committee	Separate reports for the Council and the Pension Fund deferred from July to September 2020 Audit Committee
Our responsibilities in relation to the audit of the financial statements and our wider responsibilities	✓	
Planned scope and timing of the audit	✓	
Significant audit risks and areas of management judgement	✓	
Our commitment to independence	✓	✓
Responsibilities for preventing and detecting errors	✓	
Materiality and misstatements	✓	✓
Fees for audit and other services	✓	
Significant deficiencies in internal control		✓
Significant findings from the audit		✓
Significant matters discussed with management		✓
Our conclusions on the significant audit risks and areas of management judgement		✓
Summary of misstatements		✓
Management representation letter		✓
Our proposed draft audit report		✓

Further outputs from our audit (and planned dates, based on our current understanding of the statutory timetable) include:

- Audit Committee Progress Reports – January and June 2020
- Value for Money Conclusion – September 2020 (included within our Audit Completion Report and draft audit report)
- Audit Opinion on the Pension Fund Annual Report – September 2020
- Audit Report on the 2019/20 Whole of Government Accounts return – November 2020

APPENDIX 2 – CIPFA YEAR END BULLETIN

CIPFA's Bulletin 05 on the Closure of the 2019/20 Financial Statements (May 2020) summarises the key points for local authorities to consider and includes a particular focus on areas impacted by the COVID-19 pandemic. A copy of the Bulletin can be found via the following link:

<https://www.cipfa.org/policy-and-guidance/cipfa-bulletins/cipfa-bulletin-05-closure-of-the-201920-financial-statements>

We have included below a summary of the matters highlighted in the Bulletin and their impact on our audit approach.

Topic	Description	Comment
Dedicated Schools Grant	The Bulletin confirms the expected accounting and disclosure of deficit and surplus balances carried forward in the 2019/20 accounts.	We have discussed the topic with management and the Council is expected to prepare its draft financial statements following the CIPFA guidance.
Accounting for McCloud and Sargent Judgements in 2019/20	The Bulletin provides updated guidance on the recognition and accounting for these liabilities.	We have discussed the topic with management and the Council is expected to prepare its draft financial statements following the CIPFA guidance.
Changes to the 2019/20 financial reporting deadlines	The Bulletin confirms the changes to the 2019/20 timetable	The accounts timetable and our planned audit dates have been changed to reflect the new dates.
Deferral of the implementation of IFRS16	The implementation of IFRS 16 Leases has been deferred for one year in-line with the government's Financial Reporting Advisory Board's proposals for central government departments. The effective date for implementation is now 1 April 2021.	Management is aware of this deferral.
Going concern basis of accounting	The Bulletin confirms that despite the impact of COVID-19 on local authority financial sustainability the going concern basis of reporting in the Code and the rationale behind it remains unchanged. The Bulletin does though highlight the need for local authorities to report on the impact of financial pressures in the narrative report will also need to ensure that their reports on credit risks in the financial statements appropriately reflect the impact of the COVID-19 pandemic.	We have discussed this with management and the matters highlighted in the Bulletin are being considered as part of the preparation of the draft 2019/20 financial statements.
Accounting for COVID-19 support measures	The Bulletin clarifies the role of councils as 'agents' or 'principles' in the distribution of grants and the expected accounting treatment.	Management is aware of the guidance and the reporting requirements.
S.31 Grants for 2020/21 paid in 2019/20	The Bulletin sets out the issues to consider in recognising this income in the 2019/20 financial statements.	Management is aware of the guidance and expected to prepare its draft financial statements following the CIPFA guidance.

APPENDIX 2 – CIPFA YEAR END BULLETIN (CONT.)

Topic	Description	Comment
Financial reporting issues arising from COVID-19	<p>The issues highlighted include:</p> <ul style="list-style-type: none"> • The assessment and disclosure of relevant events after the reporting period • Impact on land and buildings valuations • Fair values of investments and investment properties • Expected Credit Losses • Narrative Reporting • Reporting significant accounting judgements and estimation uncertainty. 	<p>We have discussed these matters with management and the issues highlighted in the Bulletin are being considered as part of the preparation of the draft 2019/20 financial statements. The matters relating to land and buildings valuation overlaps with a significant audit risk identified in our Audit Strategy Memorandum and will therefore be a specific are of focus for our audit work and reporting.</p>
Impact of COVID-19 on Pension Fund investment measurement and Impairment	<p>The Bulletin highlights a number of significant matters relating to the impact of COVID-19 on year end values and the increased estimation uncertainty. The Bulletin identifies the importance of pension funds engaging early with its fund managers, custodians and investment advisers to ensure it is well placed to prepare materially accurate financial statements and make disclosures (regarding, for example, estimation uncertainty) which are complete and up to date.</p>	<p>We have discussed these matters with management and the issues highlighted in the Bulletin are being considered as part of the preparation of the draft 2019/20 financial statements. This overlaps with a significant audit risk identified in our Audit Strategy Memorandum and will therefore be a specific are of focus for our audit work and reporting.</p>

CONTACTS

Director (Lincolnshire County Council)
Mark Surridge

Mobile: 0787 597 4291

Email: mark.surridge@mazars.co.uk

Partner (Lincolnshire Pension Fund)
Cameron Waddell

Mobile: 078 137 52053

Email: cameron.waddell@mazars.co.uk

Senior Manager
Mike Norman

Mobile: 0790 998 4151

Email: michael.norman@mazars.co.uk