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LANCASTER CITY COUNCIL
Promoting City, Coast & Countryside

Planning report to the Audit Committee for the year ending 31 March 2021

Issued on 15 March 2022 for the meeting on 23 March 2022

Contents

01 Planning report

Director introduction	3
Responsibilities of the Audit Committee	5
Our audit explained	6
Scope of work and approach	7
Continuous communication and reporting	9
Materiality	10
COVID-19 pandemic and its impact	11
Significant risks	13
Value for Money	18
Revisions to Auditing Standards	19
Objection to Accounts	23
Purpose of Our Report and Responsibility Statement	24

02 Appendices

Fraud responsibilities and representations	27
Independence and fees	28
Fees	29
Our approach to quality	30

Director introduction
The key messages in this report:

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

I have pleasure in presenting our planning report to the Audit Committee for the 2021 audit. I would like to draw your attention to the key messages of this paper:

COVID 19	The Local Government accounts timetable has been delayed in 2021 due to the impact of COVID – 19. The Council's draft accounts were submitted in line with the revised 31 August date however owing to delays in respect of the 2019/20 financial statements, and as reported at previous Committee meetings, we were not able to complete the audit by the revised deadline of 30 November. We are working proactively with management in respect of the 2021 audit. The implementation of IFRS 16 has also been delayed into the 21/22 Code due to COVID-19.
Scope of Our Work	Our audit work will be carried out in accordance with the requirements of the Code of Audit Practice ('the Audit Code') and supporting guidance published by the National Audit Office (NAO) on behalf of the Comptroller and Auditor General. The Audit Code sets the overall scope of the audit which includes an audit of the accounts of the Council and work to satisfy ourselves that the Council has made proper arrangements to secure Value for Money (VfM) in its use of resources. There have not been any changes to the Audit Code itself and therefore the scope of our work is broadly similar to the scope of work set in the prior year. Our responsibilities as auditor, and the responsibilities of the Council are set out in ''PSAA Statement of responsibilities of auditors and audited bodies: Principal Local Authorities and Police Bodies'' published by Public Sector Audit Appointments Limited.
Regulatory change	Our audit is carried out under the Code of Audit Practice issued by the National Audit Office (NAO). We will update Management and the Committee with sector and technical updates as they arise.
Value for Money	The National Audit Office's 2020 Code of Audit Practice revises the scope of the required work of the auditor on bodies' arrangements to secure value for money, moving away from a binary conclusion on arrangements in the audit report to a narrative commentary in a new "Auditor's Annual Report" (which replaces the Annual Audit Letter). The new requirements in this area are discussed further on page 18.

Director introduction
The key messages in this report (continued):

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

Areas of focus in our work on the accounts	We summarise below the areas of significant risk we have identified to date. • Valuation of properties – there is significant judgement over the inputs to the valuation. We note that in financial year 2019/20, the Royal Institute of Chartered Surveyors issued guidance that COVID-19 introduced a material uncertainty over the valuations completed for years ending 31 March 2020. Consequently an emphasis of matter paragraph will be included within our audit opinion in respect of the 2019/20 valuations. For the year ending 31 March 2021, there is a risk over inputs, for example gross internal areas, selection of indices and identification of relevant market data, due to the ongoing COVID-19 disruption. • Revenue Recognition – Classification of COVID-19 Grants is considered a significant judgement. Due to the ongoing pressures of COVID-19, the Council has received a large sum of grant funding. This funding can be in the form of principal or agent, whereby the classification has an effect on its accounting treatment and subsequent recognition as income within the year-end accounts. Due to its subjectivity and large increase in 2020/21, this is deemed a significant risk area. • Management override of controls – auditing standards presume there is a risk that the accounts may be fraudulently misstated by management overriding controls. Key areas of focus are: bias in the preparation of accounting estimates; inappropriate journal entries; and transactions which have no economic substance.
Audit quality	Audit quality is our number one priority. Our plan is compiled I conjunction with management and we are committed to delivering a high quality audit.

Paul Hewitson
Lead Audit Director

Responsibilities of the Audit Committee

Helping you fulfil your responsibilities

Why do we interact with the Audit Committee?

To communicate audit scope

To provide timely and relevant observations

To provide additional information to help you fulfil your broader responsibilities

As a result of regulatory change in recent years, the role of the Audit Committee has significantly expanded. We set out here a summary of the core areas of Audit Committee responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there is key information which helps the Audit Committee in fulfilling its remit.

Oversight of external audit

- At the start of each annual audit cycle, ensure that the scope of the external audit is appropriate.

- Make recommendations as to the auditor appointment and implement a policy on the engagement of the external auditor to supply non-audit services.

Integrity of reporting

- Impact assessment of key judgements and level of management challenge.

- Review of external audit findings, key judgements, level of misstatements.

- Assess the quality of the internal team, their incentives and the need for supplementary skillsets.

- Assess and advise the Council on the appropriateness of the Annual Governance Statement, including conclusion on value for money.

Internal controls and risks

- Review the internal control and risk management systems - Explain what actions have been, or are being taken to remedy any significant failings or weaknesses.

Oversight of internal audit

- Consider annually whether the scope of the internal audit programme is adequate.
- Monitor and review the effectiveness of the internal audit activities.

Whistle-blowing and fraud

- Ensure that appropriate arrangements are in place for the proportionate and independent investigation of any concerns that are raised by staff in connection with improprieties.

Our audit explained

We tailor our audit to your business and your strategy

Identify changes in your business and environment

We have spent time with management understanding the matters applicable to the financial year 20/21 matters and prepared our risk assessment for the audit. We will continue to keep this under review throughout the audit process.

Scoping

We anticipate our scope to be in line with the Code of Audit Practice issued by the NAO.

In our final report

In our final report to you we will conclude on the significant risks identified in this paper, report to you our other findings, and detail those items we will be including in our audit report, including key audit matters if applicable.

Determine materiality

We have determined materiality of £2.0m based on the draft 2020/21 accounts (2019/20: £1.9m). This is based on 2% of gross expenditure. We will report to you any misstatements above £100,006 (2019/20: £96,000). We will report to you misstatements below this threshold if we consider them to be material by nature.

Significant risk assessment

We have identified significant audit risks in relation to the Council. More detail is given on pages 14-17.

Quality and Independence

We confirm all Deloitte network firms and engagement team members are independent of Lancaster City Council. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.

Scope of work and approach

We have four key areas of responsibility under the Audit Code

Financial statements

We will conduct our audit in accordance with the Code of Audit Practice and supporting guidance issued by the National Audit Office (''NAO'') and International Standards on Auditing (UK) ("ISA (UK)") as adopted by the UK Auditing Practices Board ("APB").

The Council will prepare its accounts under the Code of Practice on Local Authority Accounting ("the Code") issued by CIPFA and LASAAC.

We report on whether the financial statements:

- Give a true and fair view of the financial position and income and expenditure; and
- Are prepared in line with the Code of Practice on Local Authority Accounting (''the Code'').

Opinion on other matters

We are required to report on whether other information published with the audited financial statements is consistent with the financial statements.

Other information includes information included in the Statement of Accounts, in particular the Narrative Report. It also includes the Annual Governance Statement which the Council is required to publish alongside the Statement of Accounts.

In reading the information given with financial statements, we take into account our knowledge of the Council, including that gained through work in relation to the Council's arrangements for securing value for money through economy, efficiency and effectiveness in its use of resources.

Whole of Government Accounts

The National Audit Office have yet to issue the 2020/21 guidance in respect of the Whole of Government Accounts. As soon as the guidance is issued we will liaise with management surrounding any work that is required and also report in our final report to the Audit Committee any work that was required.

Value for Money conclusion

We are required to satisfy ourselves that the Council has made proper arrangements for securing financial resilience and economy, efficiency and effectiveness in its use of resources.

Further detail is included on page 18 in respect of the new arrangements for the current period.

Our responsibilities as auditor, and the responsibilities of the Council, are set out in ''PSAA Statement of Responsibilities of auditors and audited bodies: Principal Local Authorities and Police Bodies'' published by PSAA.

Scope of work and approach

Our approach

Liaison with internal audit

The Auditing Standards Board's version of ISA (UK and Ireland) 610 "Using the work of internal auditors" prohibits use of internal audit to provide "direct assistance" to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

We will review their reports and meet with them to discuss their work. We will discuss the work plan for internal audit, and where they have identified specific material deficiencies in the control environment we consider adjusting our testing so that the audit risk is covered by our work.

Using these discussions to inform our risk assessment, we can work together with internal audit to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the Council's staff.

Approach to controls testing

Our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D & I").

The results of our work in obtaining an understanding of controls and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered.

Promoting high quality reporting to stakeholders

We view the audit role as going beyond reactively checking compliance with requirements: we seek to provide advice on evolving good practice to promote high quality reporting.

We recommend the Council complete the Code checklist during drafting of their financial statements.

Value for Money and other reporting

The Code of Audit Practice requires us to report by exception in our audit report any matters that we identify that indicate the Council has not made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

Public Auditor

Under the terms of the local audit and accountability act and in accordance with AGN04 we have certain other duties including, where necessary reporting in the public interest. We are not currently aware of circumstances that would lead us to exercise the powers afforded to the appointed auditor under the act.

Continuous communication and reporting

Planned timing of the audit

As the audit plan is executed throughout the year, the results will be analyzed continuously, and conclusions (preliminary and otherwise) will be drawn. The following sets out the expected timing of our reporting to and communication with you.

Planning	Year end fieldwork	Reporting activities
Planning meetings to inform risk assessment; and agree on key judgemental accounting issues. Update understanding of key and changes to financial reporting. Review of key Council documents including Cabinet, Council and Audit Committee minutes. Document design and implementation of key controls and update understanding of key business cycles.	Substantive testing of all areas. Finalisation of work in support of value for money responsibilities. Detailed review of annual accounts and report, including Annual Governance Statement. Review of final internal audit reports and opinion. Completion of testing on significant audit risks.	Year-end closing meetings. Reporting of significant control deficiencies. Signing audit reports in respect of Financial Statements. Issuing Auditor's Annual Report. Whole of Government Accounts reporting.
Planning report (March 2022 Audit Committee)	Final report to the Audit Committee	Any additional reporting required
March 2022	Ongoing	

Ongoing communication and feedback

Materiality

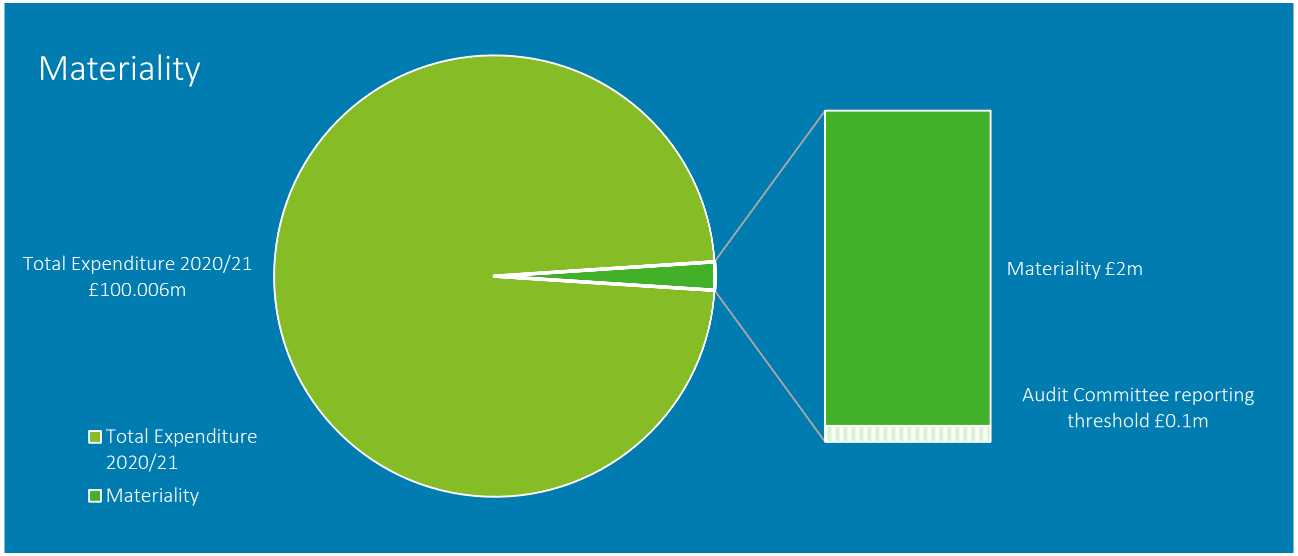
Our approach to materiality

Basis of our materiality benchmark

- The audit director has determined materiality as £2.0m (2019/20: £1.9m), based on professional judgement, the requirement of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 2% of Total Expenditure excluding expenditure on Taxation and Non-Specific Grant Expenditure based on the 2020/21 draft accounts as the benchmark for determining materiality.

Reporting to those charged with governance

- We will report to you all misstatements found in excess of £100,006 (2019/20: £96,000).
- We will report to you misstatements below this threshold if we consider them to be material by nature.



Although materiality is the judgement of the audit director, the Audit Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

COVID-19 pandemic and its impact on our audit

Requirements	CIPFA has issued guidance highlighting the importance of considering the impact of COVID-19 in preparation of the financial statements, including communicating risks and governance impacts in narrative reporting. This is consistent with the Financial Reporting Council's guidance to organisations on the importance of communicating the impact of COVID-19 and related uncertainties, including their impact on resilience and going concern assessments. Entity-specific explanations of the current and expected effects of COVID-19 and the Council's plans to mitigate those effects should be included in the narrative reporting (including where relevant the Annual Governance Statement), including in the discussion on Principal Risks and Uncertainties impacting an organisation. As well as the effects upon reserves, financial performance and financial position, examples of areas highlighted by CIPFA include the impact on service provision, changes to the workforce and how they are deployed, impacts upon the supply chain, cash flow management, and plans for recovery. Risks highlighted include those relating to subsidiaries and investments, capital programmes, and resilience of the community including partner organisations and charities.
Actions	We therefore expect a thorough assessment of the current and potential future effects of the COVID-19 pandemic including: • A detailed analysis across the Council's operations, including on its income streams, supply chains and cost base, and the consequent impacts on financial position and reserves; • The economic scenario or scenarios assumed in making forecasts and on the sensitivities arising should other potential scenarios materialise (including different funding scenarios); and • The effect of events after the reporting date, including the nature of non-adjusting events and an estimate of their financial effect, where possible.

Impact on the Council

We will consider the key impacts on the business such as:

- Interruptions to service provision
- Supply chain disruptions
- Unavailability of personnel
- Reductions in income
- The closure of facilities and premises

Impact on annual report and financial statements

We have considered the impact of the outbreak on the annual report and financial statements, discussed further on the next slide including:

- Narrative reporting
- Property valuation
- Impairment of non-current assets
- Impact on pension fund investment measurement and impairment
- Allowance for expected credit losses
- Going concern assessment
- Events after the reporting period and relevant disclosures

Impact on our audit

We have considered the impact on the audit including:

- Resource planning
- Timetable of the audit
- Impact on our risk assessment
- Logistics including meetings with entity personnel

COVID-19 pandemic and its impact on our audit (continued)

Narrative and other reporting issues	The following areas will need to be considered by local authorities as having being impacted on by the COVID-19 pandemic. • Narrative reporting as well as the usual reporting requirements will need to cover the effects of the pandemic on services, operations, performance, strategic direction, resources and financial sustainability. • Reporting judgements and estimation uncertainty, the Council will need to report the impact on material transactions including decisions made on the measurements of assets and liabilities
Property valuation and impairment of non current assets	The Royal Institute of Chartered Surveyors issued a practice alert in March 2020, as a result of which valuers have identified a material valuation uncertainty at 31 March 2020 for most types of property valuation, resulting in disclosure in financial statements and "emphasis of matter" paragraphs in audit reports. By September 2020, RICS considered that there was no longer material uncertainty over valuations from that date, and therefore valuations at 31 March 2021 are not expected to be affected by material valuation uncertainties. The Council needs to consider its approach to the measurement of property, plant and equipment (PPE). Where property held at current value is based on market valuations the Council should consider with their valuers the impact that COVID-19 has had on current value. The Council will also need to consider whether there are any indications of impairment of assets requiring adjustment at 31 March 2021.
Impact on pension fund investment measurement	As a result of the COVID-19 pandemic pension fund investments have been subject to volatility. It is important to engage early with custodians and fund managers to not only gather information for year-end measurements but to also understand any estimation techniques and any changes to those techniques that may be needed to measure the financial instruments. Where such volatility exists it may mean that the inputs used in the fair value measurement may change and may require a change of measurement technique, and consideration of the level of uncertainty in valuations where there is significantly more estimation.
Expected credit losses	Since 31 March 2020, there has been a significant downturn in economic activity, with many businesses and individuals significantly impacted. The Council will need to consider the provision for credit losses for receivables, including for expected credit losses for assets accounted for under IFRS 9.
Events after the reporting period	The economic environment and impact of the pandemic continues to be highly uncertain. The Council will need to consider the events after the Reporting Period and whether these events will be adjusting or non-adjusting and make decisions on a transaction by transaction basis. The nature of the COVID-19 pandemic will mean that the Council will need to continue to review and update these assessments up to the date the accounts are authorised for issue.

Significant risks

Our risk assessment process

We consider a number of factors when deciding on the significant audit risks. These factors include:

- the significant risks and uncertainties previously reported in the annual report and financial statements;
- the IAS 1 critical accounting estimates previously reported in the annual report and financial statements;
- our assessment of materiality; and
- the changes that have occurred in the business and the environment it operates in since the last annual report and financial statements.

Principal risk and uncertainties highlighted in the Annual Governance Statement

- Risk management and information governance
- Changes in Internal Audit provision

IAS 1 Critical accounting estimates (note 4)

- Property Valuations
- Property, plant and equipment depreciation
- Pension liabilities
- Fair Value Measurement
- Provision for NNDR Appeals
- Provision for debtors
- Impact of Brexit on asset values and pension liability

The next page summarises the significant risks that we will focus on during our audit.

We note however that some of the items included within note 4 of the accounts may not meet the definition as set out in IAS 1 and we invite management to critically consider this disclosure. We further suggest that management consider whether the impact of COVID-19 be included in this disclosure.

Changes in your business and environment

- Ongoing impact of COVID 19
- County Plan
- Mainway
- Bailrigg Garden Village
- Expansion of the Investment Portfolio

Significant risks

Significant risk dashboard

Risk	Material	Fraud risk	Planned approach to controls	Level of management judgement	Management paper expected	Slide no.
Classification of COVID-19 Grants	✓	✓	D+I	Moderate	✓	13
Property Valuations	✓	✗	D+I	High	✓	14
Management Override of Controls	✓	✓	D+I	Moderate	✗	15

D+I: Assessing the design and implementation of key controls

Low level of management judgement   Moderate level of management judgement   High level of management judgement

Significant risks (continued)

Risk 1 – Classification of COVID-19 Grants

Risk identified	ISA 240 states that when identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. We have assessed the income streams of the Council, the complexity of the recognition principles and the extent of any estimates used, and concluded that, with the exception of the funding received in 2020/21 in response to the COVID-19 pandemic, there is no significant risk of fraud. During 2020/21, the Council has received additional funding in relation to COVID-19 costs. In addition, there are a number of business support schemes designed to help eligible businesses during the COVID-19 pandemic that are being administered by Councils on behalf of the Government. We have pinpointed the significant risk in relation to the classification of whether the COVID-19 grants are 'Agent' or 'Principal'.

Our response	We will perform the following:
	
	• Assess the design and implementation of the control in relation to the determination of whether a COVID-19 grant is 'Agent' or 'Principal';
	
	• Test a sample of COVID-19 grants to confirm that they have been appropriately classified; and
	
	• Test the agency arrangement disclosures to confirm, where it is concluded that the Council is acting as agent, that:
	
	    • Transactions have been excluded from the Comprehensive Income and Expenditure Statement;
	
	    • The Balance Sheet reflects the debtor or creditor position at 31 March 2021 in respect of cash collected or expenditure incurred on behalf of the principal; and
	
	    • The net cash position at 31 March 2021 is included in the financing activities in the Cash Flow Statement.

Significant risks (continued)

Risk 2 – Property Valuation

Risk identified	The Council held £239.0m of property assets at 31 March 2020 which, as set out in the draft financial statements increased to £248.5m as at 31 March 2021. Included within this increase are net adjustments due to valuations of £12.8m. In addition the Council hold £33.2m of investment properties which decreased by £1.6m due to revaluations in the year. The Audit Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Council has adopted a rolling revaluation model which sees all land and buildings revalued over a three year cycle. As a result of this, however, individual assets may not be revalued for two years. Furthermore the Council completed the valuation as at the 1 April 2020. Any changes to factors used in the valuation process could materially affect the value of the Council's assets as at year-end. The level of judgement required in arriving at asset valuations leads us to conclude that there is a risk that that the value of property assets, including investment property, may be materially misstated.
Our response	• We will test the design and implementation of key controls in place around the property valuation, and how the Council assures itself that there are no material impairments or changes in value for the assets not covered by the annual valuation; • Where valuations of assets or classes of assets have occurred in the year we will, on a sample basis, review the methodology employed and the reliability of the valuer; • We will use our valuation specialists, Deloitte Real Estate, to support our review and challenge the appropriateness of the Council's assumptions and judgements on its assets values; • We will test a sample of revalued assets and re-perform the calculation assessing whether the movement has been recorded through the correct line of the accounts; and • Using appropriate indices we will evaluate whether assets not revalued are stated at a value materially different to their fair value.

Significant risks (continued)

Risk 3 – Management override of controls

Risk identified	In accordance with ISA 240 (UK and Ireland) management override of controls is a significant risk for all entities. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the Council's controls for specific transactions. The key judgements in the financial statements include those which we have selected to be the significant audit risks, (classification of COVID-19 grants and the Council's property valuations) and any one-off and unusual transactions where management could show bias. These are inherently the areas in which management has the potential to use their judgement to influence the financial statements.
Our response	In considering the risk of management override, we plan to perform the following audit procedures that directly address this risk: • We will test the design and implementation of key controls in place around journal entries and management judgements; • We will risk assess journals and select items for detailed testing. The journal entries will be selected using computer-assisted profiling based on areas which we consider to be of increased interest; • We will test the appropriateness of journal entries recorded in the general ledger, and other adjustments made in the preparation of financial reporting; • We will review accounting estimates and judgements for biases that could result in material misstatements due to fraud; and • We will obtain an understanding of the business rationale of significant transactions that we become aware of that are outside of the normal course of business for the Council, or that otherwise appear to be unusual, given our understanding of the entity and its environment.

Value for Money

We are required to consider the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources. Under the revised requirements of the Code of Audit Practice 2020 and related Auditor Guidance Note 03, we are required to:

- Perform work to understand the Council's arrangements to secure economy, efficiency and effectiveness in the use of resources against each of the three reporting criteria;
    - Financial sustainability: How the body plans and manages its resources to ensure it can continue to deliver its services;
    - Governance: How the body ensures that it makes informed decisions and properly manages its risks; and
    - Improving economy, efficiency and effectiveness: How the body uses information about its costs and performance to improve the way it manages and delivers its services.
- Undertake a risk assessment to identify whether there are any risks of significant weaknesses in arrangements;
- If any risks of significant weaknesses are identified, perform procedures to determine whether there is in fact a significant weakness in arrangements, and if so to make recommendations for improvement;
- Issue a narrative commentary in the Auditor's Annual Report (which replaces the Annual Audit Letter), setting out the work undertaken in respect of the reporting criteria and our findings, including any explanation needed in respect of judgements or local context for findings. If significant weaknesses are identified, the weaknesses and recommendations will be included in the reporting, together with follow-up of previous recommendations and whether they have been implemented. Where relevant, we may include reporting on any other matters arising we consider relevant to VfM arrangements, which might include emerging risks or issues.
- Where significant weaknesses are identified, report this by exception within our financial statement audit opinion.

The Annual Auditor's Report is required to be produced within three months of signing the financial statements. We expect to focus on understanding the Council's arrangements in response to the financial pressures from COVID-19 in 2020/21, and the Council's longer term planning for financial sustainability.

Revisions to auditing standards coming into effect

ISA (UK) 570 – Going concern

The Financial Reporting Council (FRC) issued a revised going concern standard in September 2019, that takes effect for periods commencing on or after 15 December 2019. For Local Government bodies, this will be March 2021 year ends and later.

The revision was made in response to recent enforcement cases and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after.

We have summarised below the key areas of change in the standard – however, the Public Audit Forum consulted on changes to Practice Note 10, which has resulted in the reflection of public sector considerations in the approach to going concern, and so the ultimate impact of ISA (UK) 570 changes will be affected by this.

The key changes affect:

- Risk assessment procedures and related activities, increasing consideration of the entity's business model, operations and financing;
- The auditor's evaluation of management's assessment of the going concern assumption (which therefore requires a clearly documented assessment);
- Enhanced professional scepticism requirements, including around the evaluation of the sufficiency and appropriateness of audit evidence;
- Considering the appropriateness of disclosures; and
- Reporting in enhanced audit reports.

"The revised standard means UK auditors will follow significantly stronger requirements than those required by current international standards."

FRC's press release, 30 September 2019

Revisions to auditing standards coming into effect (continued)

ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures

Since 2015, the International Auditing and Assurance Standards Board (IAASB) has sought to identify audit issues relating to accounting estimates for financial institutions and other entities. Initially, this focused on the impact of IFRS 9 *Financial Instruments*, because it would fundamentally change the way that banks and other entities account for loan assets and other credit exposures.

However, the IAASB concluded that most, if not all, issues identified for expected credit losses would be equally relevant when auditing other complex accounting estimates. Accordingly, a holistic revision of ISA 540 was undertaken and the new standard takes effect for periods commencing on or after 1 January 2020. For Local Government bodies, this will be March 2021 year ends and later.

We summarise on the next few slides how this will impact our audit.

"There is a clear need to update ISA 540 to support better quality audits of increasingly complex accounting estimates"

FRC letter to the IAASB, July 2017

Area of change	Impact on our audit	Impact on the Council
Area of oversight and governance relating to estimates	In connection with our planning work to understand the entity and its environment, including internal control, we will specifically inquire regarding management's processes, and the oversight and governance of those processes relating to accounting estimates.	You will need to consider the adequacy of your processes and controls over estimates, and documentation thereof.

Revisions to auditing standards coming into effect (continued)

ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures

Area of change	Impact on our audit	Impact on the Council
Identification of inherent risk factors; separate assessment of inherent risk and control risk Objectives-based work effort requirements	Recognising a spectrum of inherent risk, we will assess risks of material misstatement in estimates with reference not only to estimation uncertainty, but also complexity, subjectivity or other inherent risk factors, and the interrelationship among them. We will specifically assess control risk relating to estimates, which may require us to evaluate the design and determine implementation of an increased number of internal controls. Our subsequent audit procedures will be responsive to this assessment, and designed to obtain evidence around the methods, significant assumptions, data and (where applicable) the selection of a point estimate and related disclosures about estimation uncertainty.	You will need to provide clear documented rationale for (a) the selection and application of the method, assumptions and data in making the accounting estimate, including any changes in the current year, and controls relating to those aspects; and/or (b) the selection of a point estimate and related disclosures for inclusion in the financial statements.
Enhanced “stand back” requirement, to evaluate the audit evidence obtained	We will specifically design our procedures, to enhance our application of professional scepticism, so that they are not biased towards finding corroborative evidence; our overall evaluation of the evidence obtained will weigh both corroborative and contradictory evidence.	You should expect more challenge of the evidence provided in support of accounting estimates, use of external data sources and your consideration of contradictory evidence.

Revisions to auditing standards coming into effect (continued)

ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures

Area of change	Impact on our audit	Impact on the Council
Enhanced requirements about whether disclosures are "reasonable"	The extant ISA 540 required us to evaluate whether disclosures were "adequate". The change to "reasonable" will involve greater consideration of the overall meaning conveyed through disclosures. For example, where estimation uncertainty associated with an estimate is multiple times materiality, we will consider whether the disclosures appropriately convey the high degree of estimation uncertainty and the range of possible outcomes.	You should expect more challenge on disclosures relating to estimates, particularly for where you have selected a point estimate from a range and those with high estimation uncertainty.
New requirements when communicating with those charged with governance	In accordance with ISA (UK) 260 and ISA (UK) 265, our communications from the audit have included significant qualitative aspects of your accounting practices and significant deficiencies in internal control. With the revised ISA (UK) 540, these communications will specifically include matters regarding accounting estimates and take into account whether the reasons for our risk assessment relate to estimation uncertainty, or the effects of complexity, subjectivity or other inherent risk factors.	You should expect increased reporting in relation to accounting estimates.

Areas where we consider the impact to be greatest:

The key area impacted will be in respect of property valuations.

Use of Auditor Powers under Local Audit and Accountability Act

Objections to the financial statements

We are in receipt of an objection to the draft financial statements raised by an elector. This objection was communicated to the Authority on 10 September 2021 in which the objector raises a number of objections connected to the Luneside East Development and requests both that I consider issuing a report in the public interest and that I apply to the courts to seek that a range of issues be declared contrary to law.

Our work to date has confirmed that the objections are eligible under the terms of Auditor Guidance Note 03 and we are currently reviewing the substance of the objections. We have made enquiries of your S151 officer, Monitoring Officer and Solicitor and will make further enquiries as necessary to conclude upon these objections.

Guidance upon the process to be followed by the Appointed Auditor in respect of objections can be found in Auditor Guidance Note 04 published by the National Audit Office.

Under the PSAA contract for audit services the cost of responding to objections is not included within the scale fee and, accordingly, there will be additional audit fees arising in connection with responding to these further objections. As the scale of work required, and therefore the associated costs, becomes clearer we will share this information with your Section 151 officer.

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to establish our respective responsibilities in relation to the financial statements audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes our audit plan, including key audit judgements and the planned scope.

What we don't report

As you will be aware, our audit is not designed to identify all matters that may be relevant to the Council.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

Finally, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

Use of this report

This report has been prepared for the Council, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

Other relevant communications

We will update you if there are any significant changes to the audit plan.

We welcome the opportunity to discuss our report with you and receive your feedback.

Deloitte LLP

Leeds | March 2022

Fraud responsibilities and representations

Responsibilities explained

Your Responsibilities:

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

Our responsibilities:

- We are required to obtain representations from your management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.
- As set out in the significant risks section of this document, we have identified the risk of fraud in expenditure and management override of controls as key audit risks for your organisation.

Fraud Characteristics:

- Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.
- Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

We will request the following to be stated in the representation letter signed on behalf of the Council:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- [We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity or group and involves:
  (i) management;
  (ii) employees who have significant roles in internal control; or
  (iii) others where the fraud could have a material effect on the financial statements.]
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

Fraud responsibilities and representations

Inquiries

We will make the following inquiries regarding fraud:

Management:

- Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
- Management's process for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.

Internal audit

- Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.

Those charged with governance

- How those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.
- Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of those charged with governance on the most significant fraud risk factors affecting the entity.

Appendices

Independence and fees

As part of our obligations under International Standards on Auditing (UK), we are required to report to you on the matters listed below:

Independence confirmation	We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Council and will reconfirm our independence and objectivity to the Audit Committee for the year ending 31 March 2021 in our final report to the Audit Committee.
Fees	Our audit fees are set out on the following page. There are no non-audit fees.
Non-audit services	In our opinion there are no inconsistencies between the FRC's Ethical Standard and the Council's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.
Relationships	We have no other relationships with the Council, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.

Fees

The professional fees expected to be charged by Deloitte in the period from 1 April 2019 to 31 March 2021 are as follows:

	2020/21 £	2019/20 £
Financial statement audit including Whole of Government and procedures in respect of Value for Money assessment *	44,959	44,959
Total audit	44,959	44,959
Total fees	**44,959**	**44,959**

* In line with PSAA correspondence that scale fees should be negotiated by individual s151 officers based on the individual circumstances of each body. There will be additional fees in 2020/21 in respect of the new Value for Money standard. Both 2019/20 and 2020/21 will also include additional fees in respect of work carried out in relation to objections received to the accounts.

Our approach to quality

AQR team report and findings

Executing high quality audits remains our number one priority. We are committed to our critical public interest role and continue to embed our culture of quality and excellence into all of our people. This includes using new technology and tools to continue to transform our audit approach.

In July 2021 the Financial Reporting Council ("FRC") issued individual reports on each of the seven largest firms, including Deloitte, on Audit Quality Inspections providing a summary of the findings of its Audit Quality Review ("AQR") team for the 2020/21 cycle of reviews.

We greatly value the FRC reviews of our audit engagements and firm wide quality control systems, a key aspect of evaluating our audit quality.

In that context, overall FRC inspection results, showing an improvement since last year from 76% to 79% of all inspections assessed as good or needing limited improvement, reflect the progress we are making. The overall profile of our ICAEW inspections and our internal inspection programme also show a similar overall improvement since last year.

The results for the inspections of FTSE 350 entities fell short of our overall scores, reflecting specific findings on those particular audits rather than issues pervasive across other audits. Our objective continues to be for all of our audits to be assessed as good or needing limited improvement and we know we still have work to do in order to meet this standard.

We agree with and accept the FRC's findings on the individual inspections. The FRC has recognised improvements following the actions and programmes for previous years and we welcome the good practice points raised, including in respect of impairment and revenue where individual findings continue to occur.

Overall, we are pleased that there have been no significant findings over our firm wide processes and controls over the last three inspection cycles in the areas subject to rotational review by the FRC. However, we are continually enhancing our processes and controls across our business and such changes will directly or indirectly affect audit quality.

All the AQR public reports are available on its website.
https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports

Our approach to quality (continued)

AQR team report and findings

The AQR's 2020/21 Audit Quality Inspection Report on Deloitte LLP

"We reviewed 19 individual audits this year and assessed 15 (79%) as requiring no more than limited improvements. Of the 11 FTSE 350 audits we reviewed this year, we assessed eight (73%) as achieving this standard".

"Our key findings related primarily to the need to:

- Improve the evaluation and challenge of management's key assumptions of impairment assessments of goodwill and other assets.
- Enhance the consistency of group audit teams' oversight of component audit teams.
- Strengthen the effectiveness and consistency of the testing of revenue."

"The firm has taken steps to address the key findings in our 2019/20 public report, with actions that included increasing the extent of consultations, and enhanced learning, coaching and support programmes.

We have identified improvements, for example, in the extent of challenge of management by audit teams in respect of the estimates used for model testing. This was identified as a key finding last year.

We also identified good practice in a number of areas of the audits we reviewed (including robust procedures relating to going concern and evidence to support the challenge of management in areas of key judgement) and in the firm-wide procedures (including establishing a centre of excellence focused on credit for banking audits to encourage the consistent application of the firm's methodology and guidance)."

Our approach to quality (continued)

AQR team report and findings

Improve the evaluation and challenge of management's key assumptions of impairment assessments of goodwill and other assets

How we have addressed this area as a firm

To address this finding, we have done, or plan, the following:

- We refreshed our Impairment Centre of Excellence ("COE") to establish clear partner leadership and introduced frequent communication touchpoints to share best practice, hot topics and technical updates.
- We performed a risk focused strategic allocation of impairment specialists for a selection of December 2020 audit engagements, taking into account industry knowledge and experience. Going forward we will seek to involve the EQCR partner to determine whether the allocated specialist should have industry knowledge or whether generalist knowledge would provide an enhanced independent challenge to an industry focused engagement team.
- We will update our impairment guidance notes and consultation document to include specific risk criteria which require further discussion with a panel of specialists, including, but not limited to, where the audit team develop their own model or where cashflow forecasts extend beyond a commonly used period.
- The launch of the Digital Blueprint project management tool will assist teams in prioritising their time across all areas of the audit.
- We will hold workshops with our partners and directors to bring to life the common causes that have led to FRC findings and to ensure greater consistency in expectations in respect of the expected depth of review.
- We have introduced a new coaching program to support the development of primary reviewing skills and to identify any reviewing skills gaps which need addressing.
- To respond to the poor quality and untimely preparation of information by the company for audit, we expect, where appropriate, to increase the communication with management and those charged with governance so that there are clearer expectations in respect of the quality of information prepared for audit.
- We have updated our impairment template memo to reflect the most recent inspection findings we will develop additional training materials on hot topics and areas of regulatory focus, for example, guidance to assist in the challenge of cash flow assumptions and cost reduction initiatives.
- We also developed a new template to support teams in auditing accounting estimates in response to the requirements of ISA (UK) 540 revised 'Auditing Accounting Estimates & Related Disclosures'.

How we addressed this area in our audit

- We have considered the Council's approach to asset valuations including impairments on page 16.

Our approach to quality (continued)

AQR team report and findings

Enhance the consistency of group audit teams' oversight of component audit teams

How we have addressed this area as a firm

To address this finding, we have done, or plan, the following:

- We have appointed a partner who, together with a number of experienced directors, will lead a series of coaching workshops where we will walk through and discuss good practice examples (including those noted from external reviews) of how audit teams have undertaken group audits together with examples of where pitfalls have been identified. Those workshops will be attended by engagement teams to ensure a range of audits are covered and that those teams can also take learnings to their other group audits.
- We will also refresh our practice aid to develop a reference point for those good practice examples and learnings from the inspection cycle that will be made available to all audit practitioners. We also intend, as part of identifying good practice examples, to share templates that audit teams can use to evidence the communications held throughout the audit process with component audit teams. This will help to demonstrate the required oversight and direction performed by the group audit team by evidencing in detail the interaction / challenge / resolution of issues with component teams.
- We issued a reminder of the EQCR requirements with respect to the need to hold discussions with Key Audit Partners of material subsidiaries in our January 2021 EQCR briefing which was delivered to all EQCR reviewers.
- We have regularly communicated the FRC findings, including those on group audits to the wider audit practice during the inspection cycle through our National Accounting & Audit digest emails to ensure that audit teams who might be affected by the findings are fully briefed.

How we addressed this area in our audit

- The audit of Lancaster City Council does not involve a group team.
- We engage with the Lancashire Pension Fund auditors through our work and have conversations with them throughout the audit process.

Our approach to quality (continued)

AQR team report and findings

Strengthen the effectiveness and consistency of the testing of revenue

How we have addressed this area as a firm

To address this finding, we have done the following:

- We included a 'Substantive Analytical Review ("SAR") revenue deep dive' in our mandatory monthly professional training update in September 2020. This focused on appropriate planning, testing requirements including use of independent data sources and threshold calculations and how to avoid common pitfalls.
- Included a mandatory session on auditing revenue, which included the use of SAR within our Engagement Team Based Learning ("ETBL") coaching sessions for the 2020 programme. This focused teams on the overall approach taken in order to ensure that our teams understood transaction flows and that audit tests were designed appropriately.
- In late 2020 we updated the guidance given to consulted parties about how to respond to the consultations audit teams are required to undertake when using the audit regression software analysis to audit both revenue and cost of sales. This was to ensure that the consulted parties were being provided with all the relevant facts and circumstances when evaluating the appropriateness of using the software to assist us in performing substantive analytical procedures on both account balances in this way.
- We have held additional training sessions for our manager group which focused on reviewing skills with the aim of improving the quality of primary reviews undertaken. This will ensure appropriate focus is being placed on the review of areas where substantive analytical review is performed.

We also plan to do the following:

- For December 2021 year ends, we have introduced a new policy, which applies to listed and PIE entities in the UK and requires teams to identify and test the operating effectiveness of relevant controls for material revenue streams. Our main annual training ("TechEx"), includes a learning journey, comprised of various modules on internal controls, including a focus on the new policy as a hot topic, a deep dive session on revenue review controls, and a module on evaluating General IT Control deficiencies.
- The Deloitte Substantive Analytic Review Guide is also being updated to incorporate our learnings from these audit inspections.

How we addressed this area in our audit

We have reviewed our approach to testing revenue to ensure that it includes appropriate independent data sources and have also performed some substantive work.

Deloitte.