

External audit progress report

Northumberland County Council

Audit Committee
May 2022



1. Audit progress
2. National publications

01

Section 01: **Audit progress**

Audit progress

Purpose of this report

This report provides the Committee's May 2022 meeting with:

- an update on progress in delivering the 2020/21 audit and assurance work; and
- a summary of recent relevant reports and publications for your information (Section 2).

2020/21 assurance work

For 2020/21, we were engaged to carry out three assurance engagements, namely:

- Teachers' Pensions return;
- the pooling of housing capital receipts return to DHLUC; and
- the housing benefits subsidy return to DwP.

In our March 2022 progress report, we reported that the first two engagements were complete. The final engagement for 2020/21 was completed in April 2022, in respect of the housing benefits subsidy return to DwP. Some additional testing was required in respect of errors identified.

Audit progress

2020/21 audit

Our work on the financial statements is substantially complete. We intend to bring our 2020/21 Audit Completion Report to the Audit Committee upon completion of outstanding matters. The matters outstanding are shown in the following table and include:

- group accounts – consideration of assurance from the component auditor, once available, upon completion of the Advance external audit;
- consideration of the outcome from the independent corporate governance review.

We have set out, in the following table, a summary of progress to date, to give an overview of:

- whether key areas of work are on-going or complete;
- where complete, whether there is any material misstatement of the financial statements (where work is on-going, this is shown as 'TBC' i.e. to be confirmed); and
- some brief narrative to set out any issues arising to date, noting a full schedule will be included in our Audit Completion Report.

We would highlight that where work is shown as 'complete' in the following table, this is subject to:

- manager, partner and independent partner review; and
- our technical team's review of the final revised financial statements.

The file review process may raise queries which lead us to revisit areas completed; this is a normal part of the audit process.

Significant matters discussed with management in relation to the audit of the financial statements

Significant matters discussed with management to date have included:

- **Property, plant and equipment valuations:** this is a key area of focus.
- **Property, plant and equipment:** infrastructure derecognition of £45.021 million. This is a result of the Council's follow-up of an issue identified during the 2019/20 audit and an internal control recommendation we raised. The Council has carried out significant additional work and, following this exercise, which included going back to archived papers, writing back the majority of this infrastructure expenditure. We would highlight the national issue in respect of infrastructure set out in the 'publications' section of this report.

Audit progress

Significant matters discussed with management in relation to the audit of the financial statements (continued)

- **Pensions:** the Council obtained a revised pensions report from the Actuary, resulting in a decrease to the net pensions liability of £44.810 million. This was due to there being a significant movement in the stock market, impacting on Pension Fund asset valuations in the final quarter of 2020/21. This, in turn, led to a material difference between the estimated return on assets used by the Actuary and the actual return on assets. A similar issue was identified at other local authorities in the North East part of the same Pension Fund.
- **Exit packages:** consideration of lawfulness.
- **Senior officers' remuneration:** consideration of lawfulness.
- **Group financial statements:** prior period adjustment for an error identified in the classification between Group Usable and Group Unusable Reserves (no net impact).
- **Covid-19 grant recognition:** the impact of the pandemic and how grants from central government have been treated in the financial statements.
- **The calculation of the impairment of debtors allowance** and the impact of the economic downturn.
- **Airport shares and loan notes:** the external valuation and the assumptions made in the small upwards valuation of the Airport shares, as well as the expected credit loss for the Council's long-term loan notes to the Airport.

We are grateful to officers in the Council's finance team for their continued co-operation in undertaking the 2020/21 audit.

Audit progress

This table sets out progress on the 2020/21 financial statements audit.

Area	Status	Material misstatement?	Comments
Statutory records	Complete	No	Additional disclosure required to explain the restatement of the income and expenditure statement due to portfolio changes.
Laws and regulations	On-going	TBC	Consideration of the outcome of the corporate governance review that is currently being undertaken by SOLACE (Society of Local Authority Chief Executives and Senior Managers).
Related party transactions	On-going	TBC	Formal response to our letter from the s151 officer outstanding. Consideration of the outcome of the independent corporate governance review underway.
Movement in Reserves Statement	Complete	No	Conclusion will be revisited following completion of other work.
Expenditure testing	Complete	No	
Income testing	Complete	No	Additional work was required due to an error identified in our initial 'cut-off' testing (i.e. testing whether income was included in the correct year). Further work was carried out, with the conclusion that it was an isolated non-material error.
Grant income testing	Complete	No	
Covid-19 grant income testing	Complete	No	
Other operating income and expenditure	Complete	No	Amendment as a result of various property, plant and equipment errors (see overleaf).
Financing & investment income and expenditure	Complete	Yes	Amendment to the 'remeasurement of the net pensions liability' as a result of the revised pensions report (further details overleaf). Also amendment as a result of various Property, Plant and Equipment errors.

Audit progress

This table sets out progress on the 2020/21 financial statements audit (continued).

Area	Status	Material misstatement?	Comments
Cash flow statement	Complete	No	Conclusion will be revisited following completion of other work.
Property, plant and equipment	Complete	Yes	<p>Issues arising have included:</p> <ul style="list-style-type: none"> • delays in obtaining the required sample evidence; • schools not valued on the required 'modern equivalent asset' basis, requiring additional work by the Council which we are considering; • incorrect inclusion of a 'contingency' allowance in depreciated replacement cost valuations; • floor plan evidence not readily available for some of the sampled assets, with the Council having to undertake additional work to evidence floor areas; • capital expenditure on assets not owned by the Council incorrectly treated in the financial statements; • the write-out of £45.021 million of infrastructure assets (see earlier comment, plus national issue in respect of infrastructure); and • amendments required to disclosures. <p>We have highlighted an internal control recommendation in this area to management.</p>
Capital financing requirement disclosure	Complete	No	Discussions with management and internal challenge in respect of the Council's approach to not setting aside any revenue provision for repayment of loans where the principal is repaid over the term of the loan.
Investments	Complete	No	One direct confirmation was outstanding and has now been received.
Debtors	Complete	No	Internal control recommendation (medium priority) to be raised in respect of the lack of signed copy of one loan agreement in our sample.
Cash and cash equivalents	Complete	No	One school omitted from the bank confirmation we received; we obtained an updated confirmation from the bank.

Audit progress

This table sets out progress on the 2020/21 financial statements audit (continued).

Area	Status	Material misstatement?	Comments
Loans and borrowings	Complete	No	
Creditors	Complete	No	Non-material unadjusted error identified.
Capital grants receipts in advance (CGRIA)	Complete	No	Amendment required to the balance, to remove grants for which there were no conditions attached and, therefore, should have been credited to the income statement. A further non-material unadjusted error identified in classification between long and short-term CGRIA.
Long-term liabilities – pensions	Complete	Yes	The Council obtained a revised pensions report from the Actuary, due to there being a material difference in the 'return on assets', between what the Actuary estimated and the actual return on assets for the final quarter of 2020/21. This increase in the pension fund assets will result in a decrease to the Council's net pensions liability by approximately £44.8 million. We will also be reporting an unadjusted non-material error (subject to consideration of cumulative materiality) arising from our consideration of the assurance from the Pension Fund auditor.
Private finance initiative	Complete	No	
Financial instruments	Complete	No	Amendments required to disclosures.
Usable & Unusable reserves	Complete	No	Amendments required to disclosures.
Housing Revenue Account	Complete	No	
Collection Fund	Complete	No	

Audit progress

This table sets out progress on the 2020/21 financial statements audit (continued).

Area	Status	Material misstatement?	Comments
Firefighters' Pension Fund	Complete	No	
Provisions	Complete	No	
Contingent liabilities and contingent assets	Complete	No	Amendments required to disclosures, plus, depending on progress in reaching settlements in one area, the Council may need to consider whether there are any material post balance sheet events to consider, which may impact on disclosures.
Use of experts	On-going	No	Response outstanding from one of the Council's Valuers.
Accounting estimates	Complete	TBC	Informed by audit work in multiple other areas, therefore, remains 'TBC' until all other work completed.
Group accounts	On-going	Yes	<p>The Council plans to restate the Group accounts, following identification of an error in classification between the Group Usable and Unusable Reserves (with no net impact upon net assets of the Group). In addition, the Council plans to restate the Group Movement in Reserves Statement for classification between several areas.</p> <p>Various other group accounts amendments, including addition of a group disclosure note for senior officers' remuneration ('bandings' table).</p> <p>The external audit of Advance is nearing completion at the time of issuing this report, however, there have been various amendments required, which we will need to consider in terms of the cumulative materiality of errors. Once the Advance audit is complete, we intend to review of the audit file of the Advance auditor, as planned, to feed into our assurance for the Group financial statements.</p>

Audit progress

This table sets out progress on the 2020/21 financial statements audit (continued).

Area	Status	Material misstatement?	Comments
Senior officers' remuneration	On-going	TBC	
Exit packages	On-going	TBC	
Members' allowances	Complete	No	
Expenditure and funding analysis	Complete	No	Amendments required to disclosures.
Accounting policies	Complete	No	Amendments required to disclosures.
Disclosure of assumptions and key sources of estimation uncertainty	Complete	No	Amendments required to disclosures.
Disclosure of critical judgements	Complete	No	Amendments required to disclosures.
Going concern	Complete	No	Complete, subject to final procedures and other work.
Dedicated Schools Grant disclosure	Complete	No	Linked unadjusted non-material error will be included in our report in respect of the prior year incorrect treatment of the schools deficit for 2019/20, which was taken to an earmarked reserve; this accounting treatment is not permitted. We note this in the context of this 'negative' earmarked reserve becoming 'positive' by the end of March 2021, due to an overall schools' surplus in 2020/21.

Audit progress

This table sets out progress on the 2020/21 financial statements audit (continued).

Area	Status	Material misstatement?	Comments
Narrative report	Complete	No	Amendments will be required as a result of amendments to the primary statements.
Annual governance statement 2020/21	On-going	-	We would highlight the requirement for the Council to ensure that the Annual Governance Statement (AGS) covers the period up to and including when the opinion on the 2020/21 financial statements are signed, therefore, further work may be required, depending on any changes to the AGS.
IT general controls testing	Complete	No	One recommendation to be raised (medium-priority) in respect of the Council ensuring that any leavers have their access promptly removed from the 'Active Directory'.
Value for money	On-going	-	As we have not reported yet on the 2019/20 value for money conclusion, we cannot conclude our work in respect of the 2020/21 value for money requirements. Our conclusions for both years will be informed by the outcomes of the corporate governance review that is currently being undertaken by SOLACE (Society of Local Authority Chief Executives and Senior Managers).

02

Section 02: **National publications**

National publications

	Publication/update	Key points
Chartered Institute of Public Finance and Accountability (CIPFA)		
1.	Urgent Task and Finish Group – infrastructure, March 2021	Technical accounting issue; until this national issue is resolved, audit firms are pausing issuing opinions which are outstanding for 2020/21.
2.	Local Authority Controlled Companies: a good practice guide, May 2022	A good practice guide due to be published in May 2022; highlighted for potential interest to Committee Members, noting the full guide needs to be purchased.
National Audit Office (NAO)		
3.	Investigation into government's actions to combat waste crime in England, April 2022	This investigation responds to concerns about government's oversight of the waste industry and how action is taken to address illegal activity.
Public Sector Audit Appointments Limited (PSAA)		
4.	Annual Quality Monitoring Report 2019/20, April 2022	This covers the work of local auditors appointed by PSAA for the 2019/20 financial year. The report provides information from PSAA's quality monitoring arrangements throughout the year, survey results and findings from professional regulation and contractual compliance. The report details how the Financial Reporting Council reviewed four Mazars financial statements audits and all were assessed as meeting the required standard.

NATIONAL PUBLICATIONS

CIPFA

1. CIPFA Urgent Task and Finish Group – infrastructure, March 2021

CIPFA has established a task and finish group to address an issue regarding the derecognition of parts of infrastructure assets following 'replacement' expenditure. This is a complex and serious issue. The group will consider the issues arising, and how it might assist in their resolution. Such assistance might take the form of producing additional guidance on this issue, or including clarifications in the accounting code.

CIPFA LASAAC has instead agreed in principle to issue a consultation paper on a temporary solution so that local authorities and auditors can progress the issue and to ensure that there are no unintended consequences emanating from any options pursued. A more in-depth consultation on the issue will follow as a part of the consultation on the 2023/24 code. It is anticipated that the consultation on the temporary solution will be issued in early May 2022.

Until this national issue is resolved, audit firms are pausing issuing opinions which are outstanding for 2020/21.

Description of the issue

The issue is a technical accounting one and arises principally because of information availability relating to these assets.

Accounting for infrastructure in local government has not historically been considered to be an area of significant audit risk, due to the inalienable nature of the assets and the use of a historical cost basis of accounting. However, concerns raised by a local government auditor that some authorities are not applying component accounting requirements appropriately have recently come to light via audit network discussions convened by the National Audit Office.

The issue raised by auditors is in relation to the derecognition (removal of the carrying amount) of parts of infrastructure assets when replacement expenditure is undertaken. There are also related issues for the reporting of gross historical cost and accumulated depreciation. Infrastructure assets are one of the few categories of property, plant and equipment assets measured at historical cost rather than at an asset measurement described as 'current value'. The valuation process for these assets was deemed to be too costly and, therefore, infrastructure assets are held in local authority balance sheets at depreciated historical cost.

Normal custom and practice for (highways) infrastructure assets is that derecognition does not affect asset balances because the assets are expected to have been fully used up before the replacement expenditure takes place; this does require that assets are properly depreciated in line with the requirements of the Accounting Code. This issue arises in part because of limitations on historical information relating to when the assets were first recorded on balance sheets in the early 1990s, and where there have been transfers of assets because of local authority reorganisations. It is also extremely difficult to clearly identify the parts of the assets which are being replaced.

<https://www.cipfa.org/policy-and-guidance/urgent-task-and-finish-group-local-authority-infrastructure-assets>

NATIONAL PUBLICATIONS

CIPFA

2. CIPFA Local Authority Controlled Companies: a good practice guide, May 2022

In recent years, the potential risk associated with local authority trading companies and joint ventures has increased. Nothing is risk free, but it is important to learn lessons from others and access support.

Note this publication needs to be purchased and is due to be published in May.

<https://www.cipfa.org/policy-and-guidance/publications/l/local-authority-owned-companies-a-good-practice-guide>

NATIONAL PUBLICATIONS

National Audit Office

3. Investigation into government's actions to combat waste crime in England, April 2022

A range of organisations are involved in combatting waste crime in England. The Department for Environment, Food & Rural Affairs (Defra) has policy responsibility for waste, including waste crime, within government. The Environment Agency (the Agency) is responsible for investigating certain types of waste crime and taking action against the perpetrators, including illegal waste sites, illegal dumping (the most serious fly-tipping incidents) and breaches of environmental permits and exemptions. Responsibility for clearing waste ultimately sits with the landowner or land manager, including local authorities and other public bodies such as National Highways. Local authorities also have powers and duties relating to fly-tipping, and deal with the majority of smaller incidents. HM Revenue & Customs (HMRC) has responsibility for pursuing the evasion of landfill tax in England.

In 2018, the government published a range of documents setting the course for waste crime policy. The 25-Year Environment Plan set the ambition to eliminate waste crime and illegal waste sites within 25 years. The Resources and Waste Strategy reiterated that goal and set out government's approach and planned action to combat waste crime over the short to medium term. The 2021 Environment Act includes changes to elements of the law on waste enforcement and regulation.

This investigation responds to concerns expressed by MPs about government's oversight of the waste industry and how action is taken to address illegal activity. Concerns related partly to a HMRC investigation into suspected systematic abuse of the landfill tax system referred to as Operation Nosedive, which cost more than £3 million but ended in plans to pursue prosecutions being abandoned.

While Defra and the Agency have a good understanding of the nature and complexity of waste crime, the Agency does not currently have the data it needs to identify and assess the full extent of all waste crime, which makes it difficult to prioritise its response effectively. The Agency acknowledges that the more it looks for incidents of non-compliance with waste regulations, the more waste crime it finds, and that for some types of waste crime the reported statistics underestimate the true extent. Available evidence indicates that the incidence and cost of dealing with waste crime across England is increasing. Landfill tax changes have, as intended, led to a reduction in landfill volumes but have also increased the financial incentives to commit waste crime. Barriers to operators entering the waste sector are low, and sanctions and prosecutions for committing waste crime may not be acting as effective deterrents.

Reported fly-tipping incidents have been increasing over the past decade. The number of fly-tipping incidents reported by local authorities has been broadly increasing since 2012/13, reaching more than 1.13 million incidents in 2020/21. In 2020/21: most fly-tipping incidents involved household waste; the most common place for fly-tipping to occur was on highways; and incidents equivalent in size to a 'small van load' were the commonest category. Local authorities reported that clearing the largest categories of fly-tipped waste cost them £11.6 million in 2020/21.

NATIONAL PUBLICATIONS

National Audit Office

3. Investigation into government's actions to combat waste crime in England, April 2022 (continued)

Local authorities make extensive use of fixed penalty notices against fly-tippers. Between 2014/15 and 2020/21, local authorities recorded seven million incidents of fly-tipping and investigated 31% (2.2 million) of these, although the proportion investigated fell from 35% to 28% over the period. Of nearly one million actions taken in response by local authorities, the most common were issuing a fixed penalty notice (43%) or a warning letter (39%). In contrast, only 2.4% resulted in a caution or prosecution. Nearly three-quarters of prosecutions led to a fine of £500 or less, but there were 10 fines of more than £20,000, 163 custodial sentences, and 1,494 vehicles were seized.

The goal of eliminating waste crime provides the Agency with a clear vision to inform its strategy and performance management. The introduction of the Resources and Waste Strategy in 2018 was an important step forward although it was not intended to include all the actions needed to eliminate waste crime. Government's progress with implementing the actions has been slower than it had hoped. However, the Joint Unit for Waste Crime is showing early signs of progress, and Defra has strengthened requirements for obtaining environmental permits and is planning further reforms. The government plans to review progress regularly and consider what further actions are needed, but it does not yet have appropriate performance indicators to support this.

<https://www.nao.org.uk/report/investigation-into-governments-actions-to-combat-waste-crime-in-england/#>

NATIONAL PUBLICATIONS

Public Sector Audit Appointments Ltd

4. Annual Quality Monitoring Report 2019/20

This covers the work of local auditors appointed by PSAA for the 2019/20 financial year, which was undertaken during a difficult time for all concerned. The systemic issues that were highlighted in Sir Tony Redmond's Review continued and were compounded by the pandemic.

In September 2020 Sir Tony Redmond's review of local authority financial reporting and external audit was published. The report highlighted the significant challenges and turbulence within the new system of local audit, emphasising that at present local government audit is under-resourced, undervalued and is not having impact in the right areas. The report made a number of recommendations in relation to external audit regulation, smaller authorities' audit regulation, the financial resilience of local authorities and the transparency of financial reporting.

In December 2020 the Ministry of Housing, Communities and Local Government (MHCLG) delivered its initial response to the Redmond Review setting out proposed actions to implement the majority of the recommendations made in the report. This was followed by a further announcement in May 2021 which proposed that the Audit, Reporting and Governance Authority (ARGA) would carry out the hugely important role of the local audit systems leader. ARGA is the new regulator being established to replace the FRC and will contain a dedicated local audit unit which will play a key leadership and coordination role in the local audit framework. MHCLG consulted in Summer 2021 on how the new arrangements would function.

The next year is likely to continue to be very challenging for all involved in local audit, but DLUHC (formerly MHCLG) will take forward and refine its proposals in its role as interim systems leader until ARGA is created, and the FRC will create a local audit unit in shadow form.

The problems that Sir Tony Redmond reported on continue to impact significantly on the timely completion of local government audits. Only 45% of audit opinions were completed by the publishing date of 30 November 2020, compared with 58% in the previous year. This has now fallen even further with only 9% for 2020/21 audits of financial statement opinions completed (noting the reversion to a 30 September publishing date). Delayed audit opinions have a real public-facing impact, undermining the ability of local bodies to account effectively for their stewardship of public money to taxpayers. It is imperative that the whole system works together to restore timely completion of audits in order to rebuild public confidence and trust, especially as the lack of a statutory deadline for the audit opinion means that co-operation is essential to make the system work as the public has the right to expect it to.

<https://www.psaa.co.uk/managing-audit-quality/annual-audit-quality-reports-from-2018-19/annual-reports/audit-quality-monitoring-report-2019-20/>

Contact

Mazars

Partner: Cameron Waddell

Email: cameron.waddell@mazars.co.uk

Mazars is an internationally integrated partnership, specialising in audit, accountancy, advisory, tax and legal services*. Operating in over 90 countries and territories around the world, we draw on the expertise of 40,400 professionals – 24,400 in Mazars' integrated partnership and 16,000 via the Mazars North America Alliance – to assist clients of all sizes at every stage in their development.

*where permitted under applicable country laws.

www.mazars.com

Follow us:

LinkedIn:

www.linkedin.com/company/Mazars

Twitter:

www.twitter.com/MazarsGroup

Facebook:

www.facebook.com/MazarsGroup

Instagram:

www.instagram.com/MazarsGroup

WeChat:

ID: Mazars