AUDIT AND ASSURANCE COMMITTEE
Meeting date: 29th July 2020
From: Director of Finance (S151 Officer)

ACCOUNTS PREPARATION 2019/20

1.0 EXECUTIVE SUMMARY

1.1 ***This report summarises the progress to date on the preparations for the Council's and Cumbria Local Government Pension Scheme Statement of Accounts 2019/20 and provides an update on the previous report to the March 2020 Audit and Assurance Committee.***

1.2 ***The unaudited Statement of Accounts will be published before the statutory deadline of 31st August 2020, in accordance with the Accounts and Audit (Coronavirus) (Amendment) Regulations 2020, and the Audited Statement of Accounts will be presented to Audit and Assurance Committee once the audit is completed.***

2.0 STRATEGIC PLANNING AND EQUALITY IMPLICATIONS

2.1 ***This report supports the priorities of the Council Plan, as effective management of financial resources is a pre-requisite for making informed decisions when planning and delivering Council services.***

3.0 RECOMMENDATION

3.1 ***Members are asked to note the following:***

a. Revised High level timetable for the closedown of the Council's and the Cumbria Local Government Pension Scheme 2019/20 accounts. (paragraph 4.29) to comply with statutory requirements.

4.0 BACKGROUND

Cumbria County Council Statement of Accounts

Closure of 2019/20 Accounts

4.1 The March Committee meeting agenda included a report which set out the plans for the preparation of Accounts 2019/20. It was intended to follow a similar timetable to 2018/19 for the closure activity. The timetable is set out in **Appendix 1**.The deadline for the sign off of the unaudited accounts by the Director of Finance was Friday 29th May. This has been subsequently revised and the Council intends to publish its draft accounts by 31st July 2020, in advance of the statutory deadline of 31st August 2020.

4.2 The Accounts and Audit Regulations 2015 require each Local Authority to publish its unaudited annual accounts (including the accounts of the Local Government Pension Scheme) by 31st May and publish its complete and audited accounts by 31st July. To help ease the burden on Local Authorities arising as a result of the unprecedented situation across the UK relating to COVID-19, the Government issued revised Regulations (Accounts and Audit (Coronavirus) (Amendment) Regulations 2020) for the production of the 2019/20 accounts.

4.3 The revised Regulations apply to the 2019/20 accounting year only and the changes are:

- Extend the statutory audit deadline from 31st July to 30th November 2020.
- Remove the requirement for the public inspection period to include the first 10 working days of June.
- Commence the public inspection period on or before the first working day of September 2020. This means that unaudited accounts must be published by 31st August 2020 at the latest. They may be published earlier.

4.4 Authorities must still publish the dates of their public inspection period, as in previous years. MHCLG recommends that a public notice should be placed on the website when the public inspection period would usually commence (i.e. 1st June), explaining why there is a change for this year.

4.5 In considering the impact upon the preparation of the Accounts, the availability of information from the external sources listed below led to a revision to the timetable.

- **Information from District Councils** - Business Rates and Council Tax information is required from all six District Councils, the timetable already assumed that estimates would be used with confirmation prior to publication of the Accounts. MHCLG have extended the deadline for the District Councils to submit their Business Rates returns to the end of July. The impact of any delays in receiving the information is minimal as there isn't a material impact on the Council's Accounts.

- **LGPS IAS19 information from Mercers** – the initial information from Mercers received on 19th March showed a substantial reduction in the net liability. The Council opted to have the IAS19 re-run based on actual data for the year and the market conditions at 31st March. The revised figures were received on 11th May and these showed a small decrease in the net liability.

- **Cumbria County Holdings Ltd (CCHL)** – the provision of group Accounts which are then consolidated with the Council's Accounts. Draft group Accounts are normally received in early May but it was agreed with CCHL that this could be extended to 29th May.

- **Cumbria Pension Fund –** whilst the Pension Fund Accounts are separate from the Council's they are published at the same time as part of one document which consists of the Council's Accounts, the Group Accounts, the Firefighters Pension Fund and the Cumbria LGPS Fund. To allow time for there to be more certainty on the valuation of some assets a revised timetable was produced which saw the unaudited Pension Fund Accounts being completed by 26th June.

Revaluation of Land and Buildings in 2018/19 - background

4.6 Each year the Financial Reporting Council (FRC) undertake a review of a number of audits undertaken by private sector audit firms. In respect of the Grant Thornton, the Council's 2018/19 audit file was one of those randomly selected by the FRC for review. Members will remember the Audit for 2018/19 was completed by 31st July 2019 and the Committee was pleased to receive an unqualified audit opinion.

4.7 In relation to the process undertaken by the FRC, all aspects of the external audit are reviewed. In responding to a query from the Grant Thornton team during June relating to Plant, Property and Equipment it was identified by the Council's in-house Valuation Team that they had, unfortunately included an arithmetic error in the depreciated replacement cost (DRC) valuation template used to calculate the value of some of the Council's buildings in 2018/19.

4.8 Depreciated replacement cost (DRC) is a method of valuation which provides the current cost of replacing an asset with its modern equivalent asset less deductions for physical deterioration and all relevant forms of obsolescence and optimisation.

4.9 DRC is generally used as the method of valuing land and buildings for specialised assets such as schools, fire stations, libraries and care homes. It is not a market value. For example, in relation to school valuations, pupil numbers is one variable that is built into the calculation. At 31st March 2019 the Council's original net book value for Property, Plant and Equipment was £1,203.962m, of this £484.265m related to land and buildings. 97% or

£469m of the Council's land and buildings are valued using the DRC method.

	Valued at Depreciated Replacement Cost	Valued at Existing Use Value	Valued at Market Value	Total Land & Buildings
	£m	**£m**	**£m**	**£m**
31st March 2019	101.391	7.008	0.171	108.569
31st March 2018	73.581	0.295	0.738	74.614
31st March 2017	95.720	0.445	0.467	96.632
31st March 2016	133.401	0.407	0.604	134.412
31st March 2015	64.514	5.188	0.336	70.038
Total Net Book Value	**468.607**	**13.342**	**2.316**	**484.265**
% of total	**96.77%**	**2.76%**	**0.48%**	**100%**

4.10 The Valuation Template is a complex spreadsheet, which includes an analysis of build costs taken from the RICS BCIS (Building Cost Information Service) which is an industry recognised provider of cost and price information for the UK construction industry. It is updated for specific inflation indices on an annual basis, quarter by quarter.

4.11 The Valuation Template had an incorrect base index date for build costs which resulted in the full increase in build costs not being realised in the valuations for 2018/19.

4.12 The valuation template had been used in November 2018 for another piece of work exploring the re-basing of build costs using indices with a different base year. However when this piece of work was completed the index wasn't changed back to the base year used in the valuation of assets for the annual accounts, thus leading to the arithmetical error and understatement of the value.

Revaluation of Land and Buildings in 2018/19

4.13 The Finance team have undertaken a considerable amount of work in conjunction with the Valuation Team to understand the impact on the 2018/19 valuation of assets.

4.14 The first stage in reviewing the impact involved checking all DRC valuations and re-work where necessary. The Valuation Team concluded that all 39 of the 2018/19 building valuations were affected by the arithmetic error and after being corrected there was a potential understatement of Property, Plant and Equipment on the Balance Sheet of £17.474m or 1.45%.

4.15 Secondly, the assets that had not been revalued in 2018/19 were assessed again to determine whether the Balance Sheet was still materially correct. This piece of work concluded that there was a potential understatement of some £35m, at which stage a further 63 desktop valuations of buildings were undertaken with the final figure being £32.001m (2.66%).

4.16 The buildings selected to be valued were selected from those hadn't been revalued for the longest period of time, i.e. that were last valued in 2015/16 and 2016/17, across the full range of buildings type, to provide a thorough assessment of potential impact.

4.17 The assets not revalued were then reassessed, concluding that there were no further material differences in asset values.

4.18 The above values are indicative of a Prior Period Adjustment (PPA) being required. The CIPFA Code of Practice on Local Authority Accounting requires that where a mathematical mistake such as has occurred in the 2018/19 valuations then the error should be corrected by retrospective restatement, in the first financial statements issued following the discovery of the error correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.

4.19 Prior Period Adjustments are commonplace and are used to reflect changes in accounting policies and accounting estimates as well as correcting errors. In four out of the last five years the Council's Accounts have contained a restatement of some description. In the 2018/19 Accounts, the prior year 2017/18, was restated to reflect the change in the Council's management structure.

4.20 As a result of the DRC review, the Balance Sheet will be restated for 2018/19 and will be included in the 2019/20 unaudited Accounts by adjusting the 2018/19 comparative figures and associated notes and disclosures. These adjustments will then be subject to audit in the usual manner as part of the external audit of the 2019/20 annual accounts.

4.21 The amendment to the accounting deadlines for 2019/20 has allowed the Council to take the time necessary to carry out this review prior to the publication of the unaudited Accounts. As the same arithmetic error had been carried forward to the 2019/20 valuations the valuations that had already been completed for 2019/20 were re-done.

Revaluation of Land and Buildings in 2018/19 – reasonableness

4.22 The Valuation team provide a comprehensive service in preparing property valuations, in line with industry practice to support the preparation of the annual accounts. Their technical expertise is core to the completion of the Financial Statements and associated disclosure notes. The Finance team undertake quality assurance checks for reasonableness on the valuations each year and in relation to Depreciated Replacement Cost, this is focused on identifying where there has been a significant change from the previous valuation and seeking clarification and explanation from the Valuation team.

4.23 As referred to above and in paragraph 4.8 the DRC valuation is arrived at by taking into account of a number of different factors. For example with regards to schools, pupil numbers is a factor which can cause some level of volatility in the valuations.

4.24 This arithmetic error in the indexing of the build costs in the valuation template affected one part of the overall calculation undertaken and therefore resulted in only part of the increase in costs being included in the revaluation.

4.25 The overall impact being that the revaluations looked reasonable as all valuations reflected a partial increase which appeared to be consistent with the reasons and trends identified by the Valuation team.

Revaluation of Land and Buildings – 2020/21 onwards

4.26 The review of the 2018/19 valuations and lessons learned during the preparation of the 2019/20 accounts has resulted in revised arrangements being implemented in readiness for the 2020/21 accounts process in order to further strengthen the valuation of assets:

- Additional checks have been built in to test the DRC valuation spreadsheet prior to the start of the year.
- Consideration of the re-basing of build costs to move away from a reliance on indexation.
- Reviewing where the build costs are pitched in relation to the range of build costs reported. Historically the mean cost has been used, but the lower quartile would reflect more closely the cost base of the buildings the County Council has built most recently.

4.27 The cycle of valuations is also being reviewed to reduce the current five year cycle to a three year cycle. This will be achieved by incorporating the use of more desktop valuations each year, where the factors such as build costs and pupil numbers are updated, but physical measurements are maintained at the same level.

4.28 Where there has been significant capital spend on a building during the year, exceeding 20% of the buildings net book value, then a revaluation will be automatically triggered regardless of whether it is part of the current year's cohort of revaluations.

Revised Closure of Accounts Timetable

4.29 A high level summary of the timetable is attached at **Appendix 1** for information. The original timetable published in the Committee papers for the March meeting was revised in the light of the changes to the Accounts and Audit Regulations, the challenges of the COVID-19 pandemic and again in mid-June to take account of the additional work required on valuations. Key dates are as follows:

Task	Original Planned Date	Revised Date	Date Completed
Directorate finance teams to complete all accounting entries and produce their provisional outturn report.	14th April	14th April	21st April
Directorate working papers and analytical review completed	16th April	16th April	27th April
First draft of Statement of Accounts to be produced for Senior Managers Accountancy and Technical Finance to review. Briefing to Director of Finance on Statements of Accounts.	11th May	11th May	18th May
First draft of Statement of Accounts to Director of Finance on Statements of Accounts.	14th May	30th May	9th June
Final draft of unaudited Statement of Accounts to Director of Finance	22nd May	20th July	20th July
Unaudited Statement of Accounts approved by Director of Finance, published on the website and passed to Grant Thornton together with working papers	29th May	31st July	
Outturn report to Cabinet	11th June	11th June	11th June
Audit & Assurance Committee to receive Audit Findings Report from Grant Thornton	July	23rd November	

4.30 Regular meetings are scheduled with Grant Thornton during the year (monthly from December until the end of August and weekly during the main audit period in September and October) involving the Senior Manager Accountancy and the Group Finance Manager – Corporate Accounting. These meetings provide the opportunity to raise issues early with a view to a prompt resolution before the year end.

2019/20 External Audit

4.31 The external audit to be undertaken by Grant Thornton is now scheduled for September and October with Grant Thornton's Audit Plan to be presented to the Audit and Assurance Committee on 17th September 2020 and the audit findings being reported to the 23rd November meeting.

Changes to Code of Practice on Local Authority Accounting for 2019/20 onwards

4.32 For 2019/20 there are no technical accounting changes in the Code.

4.33 IFRS16 Leases was due to be implemented in 2020/21, with the transition date being 1st April 2020. IFRS16 will require authorities that are lessees to recognise most leases on their Balance Sheets as right-of-use assets with a corresponding lease liability.

4.34 IFRS16 had already been deferred for one year for the whole Public Sector to 1st April 2020 but as a result of the Coronavirus pandemic CIPFA/LASAAC agreed to defer the implementation of IFRS 16 Leases for a further year in line with the proposals for central government departments. The effective date for implementation is now 1st April 2021.

4.35 There is still some uncertainty about the extent of the impact of IFRS16 as CIPFA/LASAAC are still deliberating on the treatment of Voluntary Aided and Voluntary Controlled Schools. For the Council this affects 126 schools which are not currently included in the Council's Balance Sheet, but depending on the outcome of CIPFA/LASAAC discussions these may be brought back on to the Balance Sheet.

4.36 The Corporate Accounting team are currently reviewing all the Council's lease arrangements in readiness for the implementation and further details of the impact of IFRS16 will be included in Note 1 Accounting Standards Issued of the 2019/20 Accounts.

5.0 Cumbria Local Government Pension Scheme ("The Fund")

Timeframe

5.1 As noted in Section 4.2, the Government has issued revised Regulations for the production of the 2019/20 accounts requiring unaudited accounts to be published by 31st August 2020 and audited accounts by 30th November 2020.

5.2 The Fund presented its unaudited accounts to the Cumbria Pensions Committee on 23rd June and these are publically available as part of the agenda items for that meeting. At the meeting, the Committee resolved to "*Submit to the Audit and Assurance Committee (subject to any final amendments) the Cumbria LGPS Accounts 2019/20 for approval on behalf of the Council.*"

5.3 The draft accounts are subject to ongoing review and, consistent with accounting practice, if a material amendment is identified during the audit process this will be reflected in the final accounts. The Fund's draft accounts were provided to Grant Thornton on 26th June for them to commence their audit.

5.4 Whilst some areas of work may not be fully complete, Grant Thornton has indicated that it expects to be in a position to issue a draft Cumbria LGPS Audit Findings Report (AFR) in late August (the report will highlight areas where work is ongoing). It is therefore anticipated that the draft AFR will be reported to the meeting of the Pensions Committee in September. Grant Thornton has also indicated that it expects to issue the audit opinion by 30th November (subject to the completion of both the County Council and Fund audits). If received by this date, the opinion will be incorporated in the Fund's published Annual Report (which must be published by 1st December).

5.5 The extension to accounts deadlines may result in narrative within the accounts being amended. In particular, the Events After Reporting Date (Note 21) - where the Fund is required to detail relevant significant events that have occurred within the Fund between 31st March 2020 and the publication of the audited accounts – may require updating before the final publication. The Note currently includes commentary regarding the impact of COVID-19 on the Fund and details of the merger of Northumberland and Tyne & Wear pension funds (two of the original partners of Border to Coast). Examples of events that may result in amendments to the Note include any further relevant information relating to the impact of COVID-19 on Fund assets, and material developments in relation to the McCloud judgement.

Estimates within the Accounts

5.6 In accordance with accounting requirements, the notes to the accounts set out the classification of asset and liability valuations into three levels, according to the quality and reliability of information used to determine their fair value (this is referred to as the 'Fair Value Hierarchy').

- Level one assets are those which are the most easily valued, such as listed equities and cash, as their values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. 9% of the Fund's assets as at 31st March 2020 were classed as level 3.

- Assets are classed as level two when, whilst quoted market prices are not readily available, there is sufficient evidence to enable the valuation to be based significantly on observable market data. This includes pooled funds where the underlying assets are quoted assets such as equity and fixed interest bonds. 56% of the Fund's assets as at 31st March 2020 were classed as level 2.

- Level three assets are those where quoted market prices are not available and where at least one input into the valuation could have a significant effect on the calculation is not based on observable market data. Examples include property, private equity and infrastructure. 35% of the Fund's assets as at 31st March 2020 were classed as level 3.

5.7 As in previous years, where the actual value of an asset is not available as at 31st March 2020 (i.e. for the level 3 assets) the accounts include estimates of asset values. These estimations are undertaken by experienced professionals, for example, the Fund's directly held property portfolio is valued by an appropriately qualified (RICS) independent property valuer (CBRE Limited).

5.8 Property: In March, CBRE advised the Fund that, due to the impact of COVID-19 on the property market, it had concluded that it could attach less weight than in prior years to previous market evidence for comparison purposes used to inform opinions of value. As a result, CBRE has incorporated a 'material uncertainty' clause in their valuation. This is unusual but not unexpected in the circumstances, affecting financial and property markets internationally. This is consistent with the approach taken nationally and both CIPFA and the Royal Institute of Chartered Surveyors (RICS) have indicated that this does not necessarily imply that the valuation cannot be relied upon. Indeed, Ben Elder FRICS (Global Director of Valuation at RICS) issued the following statement[1]:

'Where a material uncertainty clause is being used, its purpose is to ensure that any client relying upon that specific valuation report understands that it has been prepared under extraordinary circumstances.

The term is not meant to suggest that the valuation cannot be relied upon; rather, it is used in order to be clear and transparent with all parties, in a professional manner that – in the current extraordinary circumstances – less certainty can be attached to the valuation than would otherwise be the case. Indeed, with regard to the process itself, professional valuers will almost certainly have undertaken far more due diligence than normal, in order to arrive at their estimate of value.'

5.8.1 Earlier this month Grant Thornton issued an addendum to its Audit Plan for the Fund noting that it will engage its own valuer to assess the instructions to the Fund's direct property valuer, the valuer's report and the assumptions that underpin the valuation of all direct property. This is a reflection of increased regulatory focus on auditors' work on direct property valuations and Grant Thornton is taking this approach across all of its LGPS clients with significant direct property. It is understood that there will be an additional cost for this which will be recharged to the Fund – a verbal update on this will be provided to the Committee at today's meeting.

5.9 Private Equity: Valuations for Private Equity investments are usually received a quarter in arrears, but in recognition of the potential significance of market impact from the global pandemic, the Fund has taken steps to ensure these investment are valued at an estimate to the fair value at 31st March, as best as is available at the time of preparation.

5.10 Some underlying investments are by the nature of their revenues more resilient than others, e.g. healthcare versus consumer spending. Where estimates have not been available for underlying investments, the relevant managers (Aberdeen Standard and Pantheon) have provided investors with an estimated decrease in valuation due to COVID-19 reflecting an impact similar to that in the public market sector indices. All such estimated decreases are subject to a degree of uncertainty; it is a highly fluid situation

[1] https://www.rics.org/uk/upholding-professional-standards/sector-standards/valuation/valuation-coronavirus/

and, whilst May saw a recovery of much of the decline in the public markets, returns are still volatile and the economic outlook remains uncertain.

5.11 Infrastructure: The Fund's Infrastructure investments have, in general, been impacted to a lesser degree by the global pandemic, as these include operational assets in renewable and contracted energy, power distribution and utilities. The largest private market investment held by the Fund, £121.897m in JPM Infrastructure Fund, has confirmed its valuation for March 2020 including audited valuations for each underlying portfolio company.

5.12 Officers have discussed the use of estimates in the unaudited accounts with the Fund's external auditors, Grant Thornton (GT). GT noted that they would be focussing part of their audits in relation to LGPS Pension Funds on evaluating whether, in their view, sufficient audit evidence can be obtained to corroborate significant estimates such as direct property asset valuations. This may lead to them adding an "Emphasis of Matter" paragraph into the Audit Opinion and Audit Findings Report. Such a paragraph is not a qualification to the audit opinion. Instead, it is a section intended to draw the user's attention to the material valuation uncertainty.

Next steps

5.13 Grant Thornton are currently undertaking their review of the 2019/20 accounts of the Cumbria LGPS and Officers within the Pensions team will continue to work with the external auditor throughout this process. This is reported elsewhere on the agenda today.

5.14 Cumbria Pensions Committee will receive an update on the audit process at its next meeting scheduled for 15th September 2020. It is currently expected that Grant Thornton will produce a draft Audit Findings Report at the end of August to enable the Committee to consider the findings of this report.

5.15 It is currently planned for the Audit and Assurance Committee to review the final accounts of the Council, including the accounts of the Cumbria LGPS, at its meeting on 23rd November.

6.0 Role of the Audit and Assurance Committee in relation to the Accounts and the Audit Findings Report

6.1 The role of the Audit and Assurance Committee, as set out in the Constitution, in relation to the Statement of Accounts is to review the financial statements, receive the external auditor's Audit Findings Report and reports to members, letter of representation, and monitor management action in response to the issues raised by external audit.

6.2 The meeting of the Committee on 23rd November 2020 will receive:

- The audited 2019/20 Statement of Accounts including CLGPS.
- Audit Findings Report from Grant Thornton setting out their opinion on the Council's Accounts and the value for money conclusion.
- Audit Findings Report from Grant Thornton setting out their opinion on the CLGPS' Accounts.

- The letters of representation from the Council to Grant Thornton in respect of the Council and CLGPS. The letters contain written representations about the Council's financial statements and governance arrangements.
- The audited set of accounts for Port of Workington.

6.3 After considering all the above items the Committee, consistent with previous years, will be asked to:

a) Agree the Letters of Representation on behalf of the Council in respect of the two sets of accounts authorise the Director of Finance, as the Council's Section 151 (Local Government Act 1972) Officer and the Chief Executive to sign the letters this enables Grant Thornton to issue audit opinions on the accounts. Two signatures are required to fulfil the International Auditing Standards.

b) Approve the Cumbria County Council Accounts 2019/20 which incorporates the Cumbria Local Government Pension Scheme Accounts on behalf of the Council.

c) Approve the Port of Workington Harbour Accounts 2019/20 on behalf of the Council.

d) Authorise the Director of Finance, as the Council's Section 151 (Local Government Act 1972) Officer and the Chair of the Audit and Assurance Committee to sign the three sets of accounts on behalf of the Council.

e) Consider and agree the completed Action Plan to the Audit Findings Reports from Grant Thornton.

7.0 OPTIONS

7.1 Audit and Assurance Committee to note the report.

Julie Crellin
Director of Finance (S151 Officer)
20th July 2020

Please ensure that every part of this section where there is an asterisk* is completed in accordance with the instructions before sending the report to Member Services, following which please delete this sentence.

APPENDICES

***Appendix 1* Closure of Accounts 2019/20 – High Level Closure Timetable**

Appendix 2 Closure of Accounts 2019/20 report to 17th March 2020 Audit & Assurance Committee

IMPLICATIONS

Staffing: *
Financial: *
Property: *
Electoral Division(s): *

* ***Please remove whichever option is not applicable***

Executive Decision		No	
Key Decision		No	
If a Key Decision, is the proposal published in the current Forward Plan?			N/A
Is the decision exempt from call-in on grounds of urgency?		No	
If exempt from call-in, has the agreement of the Chair of the relevant Overview and Scrutiny Committee been sought or obtained?			N/A
Has this matter been considered by Overview and Scrutiny? If so, give details below.		No	

N.B. ***If an executive decision is made, then a decision cannot be implemented until the expiry of the eighth working day after the date of the meeting – unless the decision is urgent and exempt from call-in and the Head of Member Services and Scrutiny has obtained the necessary approvals.***

PREVIOUS RELEVANT COUNCIL OR EXECUTIVE DECISIONS

No previous relevant decisions.

CONSIDERATION BY OVERVIEW AND SCRUTINY

Not considered by Overview and Scrutiny

BACKGROUND PAPERS

No background papers

Report Authors:
Contact:
Paul Turney, Senior Manager – Accountancy and Financial Planning
paul.turney@cumbria.gov.uk

Fiona Parker, Group Finance Manager – Corporate Accounting
Fiona.parker@cumbria.gov.uk

Alison Clark, Senior Manager – Pensions & Financial Services
Alison.clark2@cumbria.gov.uk

Peter George – Group Finance Manager – Pensions, Treasury and Investments
peter.george@cumbria.gov.uk