



## **CORPORATE GOVERNANCE COMMITTEE – 16 MARCH 2023**

### **EXTERNAL AUDIT OF THE 2021/22 STATEMENT OF ACCOUNTS, ANNUAL GOVERNANCE STATEMENT AND PENSION FUND ACCOUNTS**

#### **REPORT OF THE DIRECTOR OF CORPORATE RESOURCES**

##### **Purpose of Report**

1. The purpose of this report is to present the key findings from the external audit of the 2021/22 financial statements and to seek the Committee's approval of the draft letters of representation.

##### **Background**

2. Grant Thornton UK LLP, the County Council's external auditor, is required to communicate the results of the 2021/22 audit of the Council's financial statements to those charged with governance prior to certifying the financial statements. The draft 2021/22 Statement of Accounts, Annual Governance Statement (AGS) and Pension Fund Accounts can be viewed on the Council's website via the following link:-

<https://www.leicestershire.gov.uk/sites/default/files/field/pdf/2022/6/30/LCC-Statement-of-Accounts-2021-2022.pdf>

3. Copies of the following reports are attached as Appendices to the report:
  - Auditor's Annual Report - covers the arrangements for value for money (VfM) - Appendix A.
  - Leicestershire County Council Audit Findings Report – Appendix B.
  - Leicestershire County Council Pension Fund Audit Findings Report – Appendix C
4. Copies of the letters of representation for the County Council and its Pension Fund are attached as Appendices D and E to this report for member consideration.
5. Mark Stocks, Key Audit Partner from Grant Thornton UK LLP, responsible for the audit will attend the Committee meeting to communicate any significant findings and answer any questions.
6. The external auditor has reviewed the financial statements, and whilst there are a few minor areas of work to complete, the auditor anticipates issuing an unqualified opinion. The auditor will provide a verbal update at the meeting.

7. The level of audit testing has continued to increase significantly compared to previous years. This stems from increased requirements on auditors from their regulators, the National Audit Office, and is reflected in the increasing levels of audit fees.
8. The financial statements also include the Annual Governance Statement (AGS). The Draft AGS posted on the Council's website in June 2022 reported three significant governance issues had arisen during 2021/22. These were:
  - SEN Budget Deficit;
  - Firs Farm – environmental damage & rectification;
  - Early Years Budget Deficit.
9. The Code of Practice on Local Authority Accounting in the UK 2021/22, requires that significant events or developments relating to the governance system that occurred between the balance sheet date, 31 March, and the date on which the financial statements will be signed by the responsible financial officer, are reported. A fourth significant governance issue has been added.
  - Local Government & Social Care Ombudsman report – Social Care Assessments.
10. A copy of the updated AGS is attached as Appendix F.
11. The updated financial statements will be reported to the Council's Constitution Committee on the 21 March 2023 for signing. The external auditor will then sign off the accounts.

### **Key Findings of the External Auditor**

#### **Annual Auditors Report 2021/22**

12. The Auditor's Annual Report (AAR) was received in February 2023. Management comments are included within the report. At the time, the audit on the financial statements had not yet been completed. This work has now been completed and the AAR has been updated.
13. The AAR is a detailed review of the value for money (VfM) arrangements at the Council. The AAR is a relatively new report, required by the National Audit Office. The first AAR, for 2020/21, was reported to the committee in January 2022. Officers have reviewed the report and their responses are included against the recommendations made.
14. The report covers five areas. These are:
  - Financial sustainability;
  - Governance;
  - Improving economy, efficiency and effectiveness;
  - The opinion on the financial statements (not yet available); and
  - Pension Fund arrangements.
15. Overall, the auditor's report is very positive. The external auditor has concluded that the Council has a good track record of sound financial management, had appropriate arrangements in place to manage the financial resilience risks, has a clear and

documented governance framework in place and a well-developed performance management framework. No significant weaknesses have been reported.

### Financial Sustainability

16. This section covers the financial outturn position for 2021/22, financial planning as part of the Medium Term Financial Strategy (MTFS) for the four years 2022-26 and the delivery of MTFS savings. The review reported that the Council has managed its 2021/22 outturn within the approved budget, has a robust organisational approach to setting the budget, has good Member engagement, the MTFS is transparent and detailed on the risks facing the Council, and that there are sound arrangements in place for identifying and delivering savings. It further adds that the capital strategy and treasury management are within the Council's prudential indicators. The report comments on the overall level of reserves (both the general fund and earmarked fund) and notes that whilst they are towards the higher end when compared with other County Councils almost half (£111m) relate to the funding of the capital programme where balances are held to fund the timing of payments included in the approved four year capital programme to reduce the need for borrowing. If this reserve was excluded the total would be around 30% and towards the very lowest end of the chart shown on page 8 of the AAR.
17. Within this section of the report two improvement recommendations were made.
18. Improvement recommendation 1: The Council should develop and implement mitigating actions to address the budget deficit forecast for 2022/23; mitigating actions to address the budget funding gaps identified in years 2024/25 to 2025/26, and robust savings plans which meet the future funding challenges
19. Management response: Agreed. The comments provided at the time of the report were: The budget for 2023/24 is balanced. The budget for later years is being updated post the Local Government settlement December 2022. This shows a slightly improved position and will be reported to the Cabinet in February 2023. The new MTFS includes actions to address the remaining budget shortfalls. The updated MTFS was reported and approved by the County Council on 22 February 2023.
20. Improvement recommendation 2: The Council should take appropriate actions to reduce its cumulative SEN deficit.
21. Management Response: Agreed, Leicestershire engaged Newton Europe to undertake a diagnostic view of the High Needs position in January 2022. Following this and a competitive tender process they have been engaged as a strategic partner to deliver an ambitious programme of SEND reform through the Transforming Special Needs and Inclusion in Leicestershire (TSIL) Programme.

### Governance

22. The main sections covered include: arrangements around risk management, internal audit and counter fraud, budget setting and monitoring and compliance with regulatory standards. The report summarises that there are: no gaps in risk management and it is a robust approach; the Council is satisfied that there is an effective internal audit service in place; annual budget setting is well developed and has a robust financial planning framework including budget monitoring; and that

Cabinet decisions are appropriate and comply with relevant legal, statutory, regulatory and budgetary requirements.

23. Three improvement recommendations were made.
24. Improvement recommendation 3: To be fully compliant with the Public Sector Internal Audit Standards, the Council should provide assurance on an annual basis that there are robust arrangements in place for managing risk. The Council must ensure there is an independent and objective review carried out by somebody not involved with the day to day process.
25. Management response: Agreed. There will be an overall review of the application of the framework either by an auditor (not involved in the day to day process) or an external body.
26. Improvement recommendation 4: To further improve and enhance the risk management framework in place, we recommend the Council: includes environmental impact within the risk impact measurement criteria, re-commence the risk management group meetings; include target risk scores on the corporate risk register; document the controls in place to mitigate risks, the assurances received any gaps that need addressing; and rolls out the Pentana system across all departments.
27. Management response: All recommendations have been agreed. Full details can be found in the AAR on page 21.
28. Improvement recommendation 5: The chief internal auditor should provide for approval, a 3 year internal audit strategy and annual internal audit plan documenting its internal audit charter, which outlines the purpose, authority and responsibilities of the internal audit activity.
29. Management response: Agreed. A strategy will be devised and the Charter will be reviewed and revised where appropriate.

#### Improving Economy, Efficiency and Effectiveness

30. This section covers performance measurement, benchmarking, service user feedback, commercial and partnerships, and procurement.
31. The report noted the Council's Annual Delivery Report and Annual Performance Compendium, and also quarterly departmental key performance measurement reporting to overview and scrutiny committees, which provide a comprehensive overview of services allowing for robust challenge and discussion. Benchmarking is also assessed to nine other county councils which shows overall that the Council is a very low spending county per head of population.
32. Service user feedback has also been reviewed, noting the council's consultation and engagement principles, that the outcomes of all engagements are published on the website, and that there is a corporate complaints and compliments register produced annually. The auditor has reported that a small number of complaints were responded to outside of the statutory timescales, and that the C&FS annual report had not been reported to the C&FS overview scrutiny committee.

33. Details to show that the Council has procedures in place to monitor financial and non-financial performance of its commercial and partnership arrangements were evidenced. In respect of Procurement, it was noted that the Council does not currently have a procurement strategy in place following the updated Council Strategic Plan. An updated sustainable procurement policy and renewed social value protocol is being developed for 2023. Clear and robust contract procedure rules were noted.
34. Improvement recommendation 6: The Council should ensure that the children's social care annual compliments and complaints register is presented to the Children and Families Overview and Scrutiny Committee for information and oversight.
35. Management response: Agreed. A separate report will be presented to the Children's & Family overview and scrutiny committee from September 2023. An overarching report which summarises all complaints is taken to the Scrutiny Commission each year but noted these should also go to the individual C&FS scrutiny committee.
36. Improvement recommendation 7: The Council should ensure that its performance monitoring processes identify instances which may breach the statutory target of responding to complaints, with a view to increasing compliance.

Management response: Agreed. A reporting framework will be developed to provide early warning of cases that risk breaching the statutory timescales.

37. The report also includes details on the audit of the County Council and its Pension Fund. These are covered in more detail in separate audit reports which are explained in more detail in the following sections of this report.

### **Audit Findings Report – Leicestershire County Council 2021/22**

38. The auditor has reviewed the financial statements and anticipates issuing an unqualified opinion. The auditor will provide a verbal update at the meeting.
39. It should be noted that, as a result of increasing regulation on audit firms, the external audit for 2021/22 has increased significantly in its coverage and expectations.
40. While there were some issues identified during the audit the auditor has reported that in respect of the significant risks identified in the audit plan; there was no evidence of management override of controls, two issues in relation to revenue recognition, no issues in respect of the risk of fraud, a minor issue in relation to the valuation of the pension fund, the Council has correctly applied the legislative and CIPFA Code of Practice requirements for infrastructure assets, and no issues in respect of the completeness of non-pay operating expenditure.
41. Overall, there were two material issues identified during the audit of the financial statements. These have been corrected and the external auditor anticipates issuing an unqualified opinion on the County Council accounts.
42. There were also some smaller potential issues raised that are not material. All but one has not been adjusted for in the financial statements as agreed with the external auditor.

### Material Items

43. Academy Land Valuations – when schools convert to Academy status the Council provides the academies with a 125-year lease but retains legal title to the land. During the 2021/22 audit the Council and the external auditor reviewed the valuation method used for school land. Following this review the Council and the auditor have now concluded that the previously agreed valuation method (to use current market value is no longer appropriate) and to instead revalue the land assets to £1 to reflect the restricted use to the authority. As a result, a prior period adjustment to the accounts has been made and a reduction of £211m to the value of land and buildings in the balance sheet as at 31 March 2022.
44. Incorrect netting off of debtor and creditor balances – the accounting records contain certain codes that are managed on a gross basis to assist with reconciliations. An example is with VAT – input tax is debited to one code and output tax is credited to a separate code. However, the net balance is what is due from or to the Council. As part of the preparation of the balance sheet an exercise is undertaken to net down these codes. On one code an error occurred and the code was incorrectly netted down. The total correction required was £43m, requiring an adjustment to gross back up debtors and creditors. This correction has been made in the accounts.

### Other Items

45. Valuation of school buildings – the basis of the valuations provided by the external valuer did not correctly include the requirements of the Department for Education (DfE) guidance in respect of school areas resulting in an understatement of the value. The valuations have now been amended and the accounts updated. The adjustment required was £4.8m as at 31 March 2021, and £5.3m cumulative as at 31 March 2022. The accounts have been adjusted for this item.
46. The following have been reviewed with the auditor and agreed to not be material and have therefore not been adjusted for in the accounts.
47. Understatement of Pension assets – in order to produce the draft accounts within the timescales required by the Accounts and Audit Regulations it is sometimes necessary to use estimates for certain entries in the draft accounts – particularly when the data is dependent on a third party. Once the actual figures are eventually reported (sometimes many months later), these can differ from the estimates used. An example is the value of pension fund assets as part of the estimate of the net pension liability as assessed by accounting standard IAS19. As at 31 March 2022 the difference relating to the Council was a reduction in the net pension liability of £2.3m
48. Potential understatement of the debtors credit loss allowance – the Council uses a combination of individual review of larger debts and estimates for smaller debts when making a provision for potential unrecoverable debts as at year end. The auditor has challenged some of the percentages used and has calculated a potential understatement of the allowance (of £2m) if higher percentages were used. However, the Council has a low historical experience of bad debt write offs and does not calculate the required provision on that basis, but it has agreed to review the percentages used.

49. Delay to the de-recognition of academy schools - there were two schools de-recognised in 2021/22 instead of 2020/21. Both schools converted to academy status during 2020/21 and should have been derecognised in that year. Processes have been updated to avoid this delay in writing out the values.
50. Movement of valuations on assets not revalued in 2021/22 – in line with the CIPFA accounting Code of Practice the Council values land and building assets on a rolling programme at least once every five years. In addition, there is a requirement to ensure that values are not materially misstated as at the balance sheet. It is impractical and expensive to value every asset every year and so high value assets are subject to more frequent valuations. As at 31 March 2022 the Council revalued almost £300m of its total £450m of land and building assets. For assets not subject to valuation as at the 31 March 2022 an accounting estimate shows that there could be a potential £2.8m increase in valuations had all assets been valued.
51. Potential overstatement of debtors balances – within a sample of invoices outstanding as at year end there was one invoice that had subsequently been credited and cancelled after year end, and one invoice that has not yet been paid while a dispute on an element of the overall charge is being resolved. This is normal in the course of business where invoices can be disputed and clarifications and corrections made. Extrapolating these examples for the overall population of debtors shows a potential overstatement of income of £1m as at 31 March 2022.

#### New Issues and Risks

52. There was a new audit engagement lead and mostly new audit team in place for the audit of the 2021/22 accounts, both on the County Council and the Pension Fund. This, together with enhanced levels of testing now required from auditors', has resulted in the identification of some areas of the accounts that could be improved and may assist the audit team in future audits. These issues are listed below and will be reviewed during summer 2023, after the 2022/23 accounts have been completed:
- General ledger code structure – number of codes used.
  - Journal postings below £20,000 – auto approved, although segregation is in place .
  - Grossing up of control codes – journals then required to net down.
  - Monthly allocations (journal postings) – process to allocate the income and expenditure net totals to the balance sheet (to balance the balance sheet).
  - Reallocation of costs – internal recharges net off on fixed codes.
  - Reconciliation of code balances – example of one code not fully reconciled.
  - Derecognition of plant and equipment disposal – fully depreciated assets, the net position is correct but the gross balances are incorrect. Housekeeping exercise required in the fixed asset register to remove assets disposed

#### Audit Fees

53. The auditor has confirmed their final audit fee for 2021/22 as £139,777 compared with the proposed fee of £114,715 in the audit plan. The increase in the fee is due mainly to the additional work required for the corrections necessary to the accounts.

#### **Audit Findings Report – Leicestershire County Council Pension Fund 2021/22**

54. The auditor's work is substantially complete and they anticipate issuing an unqualified opinion for the pension fund.
55. During the audit there was one adjustment identified totalling £7.95m relating to the valuation of hard to value pooled assets, which was not available when the accounts needed to be prepared. For these assets estimates have to be made as the valuations are not known for many months after the year end date. The amount was not material overall and this was not adjusted for in the accounts. This was agreed with the external auditor.
56. There were two control issues reported relating to; journal postings below £20,000 – auto approved (without separate approval), and senior finance officer's ability to enter journals. No irregularities were identified and management have agreed to make changes to remove the risks.
57. There were two inconsistencies identified following a review of the accounts to the pension fund annual report. These were rounding and timing differences. The annual report has been updated to agree with the Pension Fund final accounts.
58. Other recommendations made in the appendix to the auditor's report around the observations below – these were all accepted:
- No evidence of review of assumptions used in the valuation of the pension fund's direct property portfolio
  - Internal control reports and bridging letters, two fund manager reports were unavailable
  - Bodies joining the Pension Fund not accounted for (as at the year-end date) – details not available at the time the draft accounts had to be prepared.
  - IT system – access to Oracle Fusion, password configuration, and batch job management.
59. Updates were also made to some disclosure notes within the Pension Fund accounts to ensure that they fully meet the requirements of the CIPFA accounting code of practice. These are listed in the appendix to the auditor's report.
60. The auditor has confirmed their final fee for audit of the pension fund is £33,193, and £17,000 for the IAS19 assurance work (for the County Council and the auditors of the scheduled admitted bodies with a 31<sup>st</sup> March year-end). Both final fees are in line with the proposed fees in the audit plan for 2021/22.

### **Recommendations**

61. The Committee is asked to note the Auditor's Annual Report and consider the issues raised in the auditor's Audit Findings Reports and approve the draft letters of representation.

### **Background papers**

62. Corporate Governance Committee 30 September 2022 – External Audit Plan 21-22  
<https://politics.leics.gov.uk/documents/s171435/External%20Audit%20Final%20Plan%20-%202021-22%20covering%20report.pdf>



**Circulation under the Local Issues Alert Procedure**

63. None.

**Equality and Human Rights Implications**

64. There are no discernible equality and human rights implications.

**Appendices**

Appendix A – Auditor’s Annual Report 21/22

Appendix B – Audit Findings Report for Leicestershire County Council 21/22

Appendix C – Audit Findings Report for Leicestershire County Council Pension Fund 21/22

Appendix D - Letter of Representation (County Council)

Appendix E - Letter of Representation (Pension Fund)

Appendix F - Revised Annual Governance Statement

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