

THE ROYAL BOROUGH OF KENSINGTON AND CHELSEA

AUDIT AND TRANSPARENCY COMMITTEE MEETING 8 MARCH 2021

REPORT BY THE SHARED SERVICES DIRECTOR FOR AUDIT, FRAUD, RISK AND INSURANCE

PROGRESS REPORT ON INTERNAL AUDIT WORK – 2020/21

The purpose of this report is to inform the Audit and Transparency Committee of progress against the 2020/21 audit plan in the period November 2020 to January 2021.

FOR INFORMATION

1. EXECUTIVE SUMMARY

- 1.1 Although the Covid-19 pandemic has slightly delayed the start of the 2020/21 Internal Audit work, good progress is now being made in undertaking the audits contained in the revised Audit Plan and two audits have been finalised and four draft reports issued since the last report to the Committee. No overall opinion is given at this time on the adequacy and effectiveness of the Council's governance, risk management and controls.
- 1.2 **Appendix 1** shows the Internal Audit work completed as at the end of January 2021 and the status of the remaining audit work for the current year.

2. RECOMMENDATION

That the Committee consider and comment on the results of the internal audit work carried out during the period.

3. BACKGROUND

- 3.1 The Council's internal audit service is provided by the Shared Services Internal Audit Team. Audits are undertaken by the in-house audit team or by the external contractors to the service, in accordance with the Internal Audit Charter. The Audit and Transparency Committee are provided with updates at each meeting on progress against the Annual Audit Plan and on any limited or no assurance audits issued in the period.

4. INTERNAL AUDIT OPINION

- 4.1 As the provider of the internal audit service to the Royal Borough of Kensington and Chelsea, the Shared Services Director for Audit, Fraud, Risk and Insurance is required to provide the Section 151 Officer and the Audit and Transparency Committee with an opinion on the adequacy and effectiveness of the Council's governance, risk management and control arrangements.

4.2 As reported to the last meeting of the Committee, the Covid-19 pandemic delayed the start of our work in 2020/21 and no overall assurance opinion can be given at this stage, although the S151 Officer and the Committee can be assured that sufficient internal audit work is in progress to ensure an appropriate assurance opinion can be provided by the end of the financial year. In addition, the Director of Audit, Fraud, Risk and Insurance and his team are involved in supporting a number of elements of the Council’s ongoing Covid response which will help to obtain assurances to feed into the annual opinion.

5. AUDIT OUTCOMES (NOVEMBER 2020 TO JANUARY 2021)

5.1 The revised Audit Plan for 2020/21 was reviewed by the Committee in September 2020. Where significant changes in the coverage of the plan occur, these will be reported to the Committee and a full record of changes during the year is also reported within the Head of Internal Audit’s Annual report.

5.2 Since the last report to Members, no limited/no assurance audits have been issued. Despite the pandemic, we have been able to plan and undertake all of our schools audit work virtually and we have received positive feedback from the schools on our approach. In the period two school audits have been finalised as follows:

Audit	Assurance	Recommendation Priority		
		High	Medium	Low
Ashburnham Primary	Satisfactory	1	5	0
Oratory RC Primary	Substantial	0	1	0
Totals		1	6	0

5.3 In addition, four advisory reports have been issued in the following areas:

- Adult Social Care – Deprivation of Liberty Safeguards;
- Property Development – Governance;
- Resources – Review of Income Compensation Claim (1);
- Environment & Communities – Net Book Value of Refuse Vehicles.

Recommendations arising from advisory reports are followed up and the implementation of these recommendations will be reported in summary to the Committee.

6. IMPLEMENTATION OF AUDIT RECOMMENDATIONS

Eight follow-up reviews have been completed in the period which confirmed that 98 per cent of recommendations made had been or were partially implemented, with good progress made to fully implement the remaining recommendations:

Audit	No of Recs Made			No of Recs Implemented			No of Recs In Progress			No of Recs not yet actioned		
St Mary's Primary School	9			9			0			0		
All Saints College	10			10			0			0		
Community Infrastructure Levy	5			5			0			0		
Chamberlain House Dementia Resource Centre	6			6			0			0		
Supplier Resilience (CHS)	3			3			0			0		
Minimum Energy Efficiency Standards Regulations	8			5			2			1		
Mental Health Supported Service (MIND)	3			3			0			0		
Housing – H&S Temporary Accommodation	11			8			3			0		
Total	55			49			5			1		
Priority of recommendations	H	M	L	H	M	L	H	M	L	H	M	L
	6	31	18	4	29	16	2	2	1	0	0	1

Follow up work is undertaken when the majority of the recommendations made are expected to have been implemented, as indicated in an agreed management action plan. Sometimes recommendations cannot be fully implemented in the anticipated timescales. In these cases, where appropriate progress is being made to implement the recommendations, these are identified as "in progress". Recommendations will be followed up until all high and medium priority recommendations are implemented or good progress in implementing them can be demonstrated. Where appropriate, the follow up is included in the next full audit of the area.

7. CHANGES TO AUDITING STANDARD ISA 540 AND THE IMPLICATIONS FOR THE ANNUAL AUDIT OF ACCOUNTS

- 7.1 As part of their preparations for the 2020/21 audit of the Council's accounts, Grant Thornton have highlighted the need to ensure that the Committee is made aware of the increased requirements placed on them, as a result of changes to International Standard on Auditing (ISA) 540, to give more attention and focus to material

estimates, management judgements and uncertainty, during this year's audit of the accounts.

- 7.2 **Appendix 2** to this report is a briefing which has been prepared by the Chief Accountant to inform Members of the Committee about the changes made to the audit standard that covers accounting estimation, and the impact this will have on the audit of the Council's financial statements.
- 7.3 The purpose of the briefing is to ensure the Committee has sight and understanding of the Council's key estimates to enable key challenge questions to be put to officers and the external auditor when considering the annual accounts. The annual accounts include estimates in a number of areas including: property valuations, pensions liability, provisions, expected credit losses for debts and general income and expenditure accruals.

David Hughes
Shared Services Director for Internal Audit, Fraud, Risk and Insurance

Background papers:

Internal Audit Reports

If you have any queries about this Report please contact:

Moira Mackie on 0780 0513192

Email: Moira.Mackie@rbkc.gov.uk

or

David Hughes on 07817 507695

Email: David.Hughes@rbkc.gov.uk

Audit Plan 2020-21 – Status Report to end January 2021

Completed Audits:

Plan Area	Auditable Area	Assurance level given	No of High Priority Recs	No of Med. Priority Recs	No of Low Priority Recs	Reported to Committee
Adult Social Care & Public Health	Direct Payments (cfwd 2019/20)	Limited	3	5	5	Nov-2020
	Local Outbreak Control Plan	Advisory	n/a	n/a	n/a	Sep-2020
	Deprivation of Liberty Safeguards (cfwd 2019/20)	Advisory	2	7	0	Mar-2021
Schools	Asburnham	Satisfactory	1	5	0	Mar-2021
	Oratory Primary	Substantial	0	1	0	Mar-2021
Housing Management	Procurement Process – Best Practice (Advisory)	Advisory	0	6	0	Nov-2020
Social Investment	Property Development (Advisory)	Advisory	0	0	0	Mar-2021
Finance & HR	Bank Reconciliation	Satisfactory	0	3	1	Nov-2020
	Income Compensation Claim 1	Advisory	0	0	0	Mar-2021
Environment & Communities	Purchase of Refuse Vehicles (NBV)	Advisory	0	0	0	Mar-2021

Plan Area	Draft Reports	In Progress	Being Scoped	To Be Confirmed	Defer/ Cancelled
Cross-Cutting		<ul style="list-style-type: none"> • GDPR Support to DPO across all Departments • Business Continuity • Digital Accessibility 			
Adult Social Care & Public Health	<ul style="list-style-type: none"> • See also Finance & HR (Financial Assessments) 		<ul style="list-style-type: none"> • Test and Trace Grant Expenditure 		<ul style="list-style-type: none"> • Placements (to include in 2021/22 plan)
Children's Services		<ul style="list-style-type: none"> • Supporting People Claims (ongoing in year). 		<ul style="list-style-type: none"> • External Placements 	<ul style="list-style-type: none"> • Implementation of Replacement IT System (potential in 2021/22) • SEND Transport – reviewed recently so consider other areas • Youth Services – consider for future year due to Covid-19 impact on service
Schools	<ul style="list-style-type: none"> • Bousefield Primary 	<ul style="list-style-type: none"> • St Francis of Assisi Primary • Chelsea Community Hospital (CCHS) • Christchurch Primary • St Joseph's Primary • Marlborough Primary • St Barnabas & St Philip's Primary • Thematic Reviews (Health & Safety and IT Security) 			
Housing Management		<ul style="list-style-type: none"> • Acquired Properties – Ad hoc Repairs • Housing Repairs System 			

Plan Area	Draft Reports	In Progress	Being Scoped	To Be Confirmed	Defer/ Cancelled
		<ul style="list-style-type: none"> • H&Sy Compliance – Gas Safety • Income & Financial Inclusion (was Housing Rents) • Voids 			
Housing Needs & Supply					<ul style="list-style-type: none"> • Homelessness – request to defer to 2021/22
Social Investment		<ul style="list-style-type: none"> • New Homes Delivery Programme (PMO) 			<ul style="list-style-type: none"> • Landlord Responsibilities (consider in future year) • Property Strategy (request to defer to 2021/22) • New Homes Delivery Programme (Procurement) - Q1 2021/22
Customer Services		<ul style="list-style-type: none"> • Council Tax – Cyclical • Housing Benefit – Cyclical • NNDR – Cyclical 	<ul style="list-style-type: none"> • Procurement Compliance 		<ul style="list-style-type: none"> • Health & Safety Corporate Arrangements – ongoing liaison to consider requirement for formal review
Finance & HR	<ul style="list-style-type: none"> • Financial Assessments (cfwd from 2019/20) 	<ul style="list-style-type: none"> • Financial Management System, HR and Payroll Compliance • Treasury Management 	<ul style="list-style-type: none"> • Income Compensation Claim 4 (may be 2021/22) 		
IT		<ul style="list-style-type: none"> • Cyber Security follow up 			<ul style="list-style-type: none"> • Supply Chain Management (no longer required) • Asset & Access Management – delay requested due to service pressures • Projects/ Programmes – delay requested as above

Plan Area	Draft Reports	In Progress	Being Scoped	To Be Confirmed	Defer/ Cancelled
Grenfell Partnerships	<ul style="list-style-type: none"> • Grenfell Project Fund (cfwd 2019/20) 	<ul style="list-style-type: none"> • Pre-paid Card Scheme 			
Environment & Communities		<ul style="list-style-type: none"> • Emergency Planning (cfwd 2019/20) 	<ul style="list-style-type: none"> • Leisure Services – Covid Impact • Grants (VCS) 		<ul style="list-style-type: none"> • Registrar Service – defer due to Covid pressures • Libraries – see above • Parking – Carbon Reduction – consider in future year

APPENDIX 2 – BRIEFING ON CHANGES TO AUDITING STANDARD ISA 540

1. Introduction

This brief has been prepared to inform Members of the Audit and Transparency Committee of a revision to the auditing standard that covers accounting estimation, and the impact this will have on the audit of the Council's financial statements.

2. Background

Auditing Standard ISA 540 – auditing accounting estimates and related disclosures, has been enhanced to place increasing demands on auditors to understand and assess an entity's internal controls over accounting estimates.

Key changes include a requirement to:

- Consider evolving risks associated with more complex estimates with high estimation uncertainty
- Adopt a more independent and challenging sceptical mindset
- Improve dialogue between auditors and those charged with governance (Committee Members) about complex accounting estimates and those with high estimation uncertainty or subjectivity.

3. Exercise of Professional Scepticism

The Council's relationship with its external auditor, Grant Thornton, is based on mutual respect, open dialogue and a shared desire to do the right thing. The demands placed on auditors by the revisions to ISA 540 will lead to increased challenge, beginning with audit of the current year's (2020/21) financial statements.

Increased challenge includes the auditor's exercise of professional scepticism. This may be through:

- Designing and performing further audit procedures in a manner that is unbiased towards obtaining corroborative or contradictory evidence
- 'Standing back' to critically evaluate audit evidence obtained regarding the accounting estimates
- Using stronger language ("challenge", "question" and "reconsider") to reinforce the importance of exercising professional scepticism
- Focusing on management bias in risk assessments and work effort.

4. Role of the Audit and Transparency Committee

As part of this process auditors need to obtain an understanding of the role of those charged with governance, which is particularly important where the estimates have high estimation uncertainty or require significant judgement.

Specifically, auditors will seek to ascertain whether Committee Members:

- Understand the characteristics of the methods and models used to make the accounting estimates and the risks related to them

- Evaluate how management made the accounting estimates
- Are satisfied that the arrangements for accounting estimates are adequate.

5. Identifying accounting estimates

The Council's approach to identifying areas requiring estimation and the techniques used is often governed by the CIPFA Code of Practice on Local Authority Accounting ('the Code'), International Financial Reporting Standards (IFRS) and other regulations.

In all cases the Council will apply specialised skills and knowledge in exercising professional judgements around the methods and techniques it employs to derive accounting estimates. Where appropriate, it engages third party experts to assist.

Key third party experts currently used include:

Accounting Activity	Third Party Engagement
Treasury activity including cash flow forecasting	Arlingclose – independent treasury advisors
Property, Plant and Equipment portfolio valuations	JLL – professional real estate valuers
Actuarial valuations including pension liability	Barnett Waddingham – independent consultants in pensions and insurance
Business Rates Appeals calculation	Valuation Office Agency (VOA) - Analyse Local

Estimates are commonly used in accounting for the following areas:

Area of Financial Accounts	Estimation Approach
Manual debtor and creditor accruals for income receivable and expenditure payable	Income for services provided by 31 st March but not yet received and expenditure for goods / services received by 31 st March but not yet paid for are identified through budget monitoring and outturn review. Where an amount is known, which is in most cases, the accrual is raised for this value. Otherwise service accountants use past experience, similar transactions, indices and probability calculations to determine the best estimate.
Expected Credit Losses (ECL) (under IFRS 9)	Methodologies depend on the type of debt e.g. for accounts receivable, debts over £250k are individually assessed whilst amounts lower than this are grouped by type of debt and collectively assessed. Percentages applied are generally based on historical performance refined by professional experience, local knowledge and environmental factors which could affect the debtors' future ability to repay over the lifetime of the debt.
Provisions	There are prescribed tests to be met before establishing a provision, including being able to make a reliable estimate. This is done using external or systems reports, legal judgements and the experience of lead officers.
Property, Plant and Equipment (PPE)	External valuers use significant experience and informed professional judgement to model data sets and determine valuations.

Pension Liability (under IFRS 19)	Actuaries use significant experience and informed professional judgement to model data sets and determine valuations. Reports include methods and assumptions including demographics, financial and settlements. Sensitivity analysis is also undertaken for the most significant assumptions.
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6. Review of outcomes of previous accounting estimates

The nature of some estimates, including valuation of PPE and the pension liability, mean that these cannot be reviewed until the following year-end. For income and expenditure accruals, ECL and provisions, the Council carries out an annual detailed exercise to review estimated amounts against actual outcomes.

The 2019/20 review evidenced that the Council's estimation techniques are robust and produce materially accurate estimates when compared to actual outcomes.

Accounting Area	Total Value (£)	Amount Estimated (£)	Actual Outcome (£)	Variance (£)	Variance (%)
Accruals	23.903m	2.224m	1.941m	0.283m	1%

The variance on estimated accruals is shown as a percentage of total accruals raised.

Accounting Area	Total ECL (£)	Total Debt (£)	Estimated recovery (£)	Actual recovery (£)	Variance (£)	Variance (%)
ECL	47.019m	73.168m	26.149m	14.404m	11.745m	16%

This is based on collection during the first nine months of 2020/21; some debts contributing to the variance are expected to be recovered by year-end. Government guidance and policy decisions to not enforce debt collection and allow debt payment holidays during the pandemic, including on council tax and business rates, has increased the variance.

The VOA estimated the Council's Business Rate Appeals provision requirement at 31st March 2020 of £19m. They revised their estimate in January 2021 to £17m. This represents future appeals yet to be heard and the VOA is still reviewing cases from 2010 to 2017 listings. The estimate is therefore calculated on best information available at the time, using the VOA Analyse Local model based on data from other local authorities, property type, success of similar appeals and so on.

7. Risk Management

The Council uses professionally qualified industry experts to produce material estimates in all complex areas and where there is a high degree of estimation uncertainty. This includes use of actuaries, surveyors and valuers.

Data sets and other information shared with experts include details of parameters and assumptions made to ensure that they understand the data. Regular dialogue takes place to address queries and any adjustments are documented. Once valuation reports are received, the Council's area leads carry out internal reviews to check:

- Completeness – has all data provided been included?

- Reasonableness – are values in line with expectations?
- Comparison to previous reports – are there any significant variances from last year which have not been fully explained?
- Challenge – are assumptions made and techniques used within valuation models appropriate?
- Unusual items – are there any one-off or unusual items included or missing that need to be considered individually?

For accounting estimation carried out by Council officers, annually updated guidance documents are provided by the Chief Accountant to ensure staff are aware of the latest rules and processes to be followed. Workshops and training are also provided.

The Council also undertakes analytical review on all its financial statements and queries any unexpected variances, taking corrective action or providing explanation to audit as necessary.

8. Impact of COVID-19 on accounting estimation

The Council has considered the impact of valuation uncertainty arising as a result of the pandemic on key areas of the 2020/21 accounts. Discussions with third party experts are ongoing to ensure this is reflected in their valuations and officers are assessing the likely impact on impairment of debtors, using a range of sensitivity profiles.

The Council will make additional disclosures in its Narrative Report around government grants received and budget pressures linked to the pandemic.

Disclosure of significant judgements made in applying accounting policies and assumptions made about major sources of estimation uncertainty for the future will be updated to reflect the increased risk during this period of uncertainty.