

Leicester City Council Indicative Audit Risks 2022/23

Year ending 31 March 2023

19 July 2023



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The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit planning process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Council or all weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

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Key matters



National and local context

For the general population, rising inflation rates, in particular for critical commodities such as energy, food and fuel, is pushing many households into poverty and financial hardship, including those in employment. At a national government level, recent political changes have seen an emphasis on controls on spending, which in turn is placing pressure on public services to manage within limited budgets.

Local Government funding continues to be stretched with increasing cost pressures due to the cost-of-living crisis, including higher energy costs, increasing pay demands, higher agency costs and increases in supplies and services. Local authority front-line services play a vital role in protecting residents from rising costs; preventing the most vulnerable from falling into destitution and helping to build households long-term financial resilience. At a local level, councils are also essential in driving strong and inclusive local economies, through their economic development functions and measures like increasing the supply of affordable housing, integrating skills and employment provision, and prioritising vulnerable households to benefit from energy saving initiatives. Access to these services remains a key priority across the country, but there are also pressures on the quality of services. These could include further unplanned reductions to services and the cancellation or delays to major construction projects such as new roads, amenities and infrastructure upgrades to schools, as well as pothole filling.

Locally, the final out-turn for 2022/23 shows an overall overspend of £4.4m in 2022/23, albeit lower than the £10.3m forecast at period 9. The Council has reported that the overspend in 2022/23 has been caused by high inflation (including significantly increased energy costs and higher than budgeted pay awards), together with continuing – but reducing – pandemic related income shortfalls.

Our recent national value for money work has highlighted a number of governance and financial stability issues at a national level, which is a further indication of the mounting pressure on audited bodies to keep delivering services, whilst also managing transformation and making savings at the same time.

In planning our audit, we will take account of this context in designing a local audit programme which is tailored to your risks and circumstances.

Audit Reporting Delays

In a report published in January 2023 the NAO have highlighted that since 2017-18 there has been a significant decline in the number of local government body accounts including an audit opinion published by the deadlines set by government. The NAO outline a number of reasons for this and proposed actions. In our view, it is critical to early sign off that draft local authority accounts are prepared to a high standard and supported by strong working papers.

Key matters



Our Responses

- As a firm, we are absolutely committed to audit quality and financial reporting in the local government sector.
- We will consider your arrangements for managing and reporting your financial resources as part of our audit in completing our Value for Money work.
- Our value for money work will also consider your arrangements relating to governance and improving economy, efficiency and effectiveness.
- This will include the follow up of the previously agreed recommendations from our 2021/22 Annual Auditor's Report which are being taken to this meeting of the Governance and Audit Committee.
- We will continue to provide you and your Governance and Audit Committee with sector updates providing our insight on issues from a range of sources and other sector commentators.
- We hold annual financial reporting workshops for our audited bodies to access the latest technical guidance and interpretations and to discuss issues with our experts and create networking links with other audited bodies to support consistent and accurate financial reporting across the sector.
- We have identified an increased incentive and opportunity for organisations in the public sector to manipulate their financial statements due to increasing financial pressures. As such we have elevated our assessed risk for completeness of expenditure and payables. Consistent with this, and in line with the presumed risk in all financial statements, we have also planned to address a significant risk with regard to management override of control – refer to page 6

Introduction

Purpose

This document provides an overview of the indicative planned scope and timing of the statutory audit of Leicester City Council ('the Council') for those charged with governance. It sets out the risks that we anticipate will drive the focus of our audit based on our knowledge of the Council from the prior year and discussions with management. It is important to note that our risk assessment is an iterative process and we will revisit our assessment on an ongoing basis bringing any new risks to your attention if and when they arise. We will provide our formal Audit Plan for consideration subsequent to the completion of our planning and risk assessment work.

Respective responsibilities

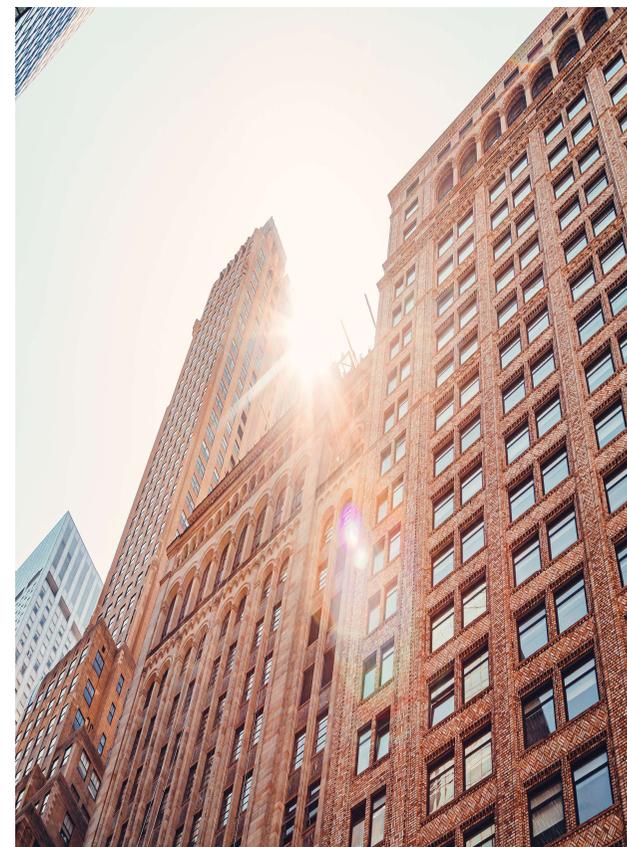
The National Audit Office ('the NAO') has issued a document entitled Code of Audit Practice ('the Code'). This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. Our respective responsibilities are also set out in the Terms of Appointment and Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA), the body responsible for appointing us as auditor of Leicester City Council]. We draw your attention to this document.

Scope of our audit

The scope of our audit is set in accordance with the Code and International Standards on Auditing (ISAs) (UK). We are responsible for forming and expressing an opinion on the Council's financial statements that have been prepared by management with the oversight of those charged with governance (the Governance and Audit Committee); and we consider whether there are sufficient arrangements in place at the Council for securing economy, efficiency and effectiveness in your use of resources. Value for money relates to ensuring that resources are used efficiently in order to maximise the outcomes that can be achieved.

The audit of the financial statements does not relieve management or the Governance and Audit Committee of your responsibilities. It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Council is fulfilling these responsibilities.

Our audit approach is based on a thorough understanding of the Council's business and is risk based.



Financial Statements Audit 2022/23

Materiality

The concept of materiality

Materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

We have not yet formally determined the materiality for the year ended 31 March 2023, but anticipate it being based on the Council's published draft gross expenditure for the year.

We estimate this to currently be £16.4m. The materiality set for our 2021/22 financial statements was £15.0m. We will confirm this when we issue a full Audit Plan.

Significant risks

Although we have started our planning work we are not at a stage where we can formally confirm the significant risks that we will be auditing. However, the sections below indicate likely areas on which we expect to focus our work.

Presumed significant risks

ISA (UK) 240 includes two presumed risks as follows:

- Revenue recognition may be misstated due to the improper recognition of revenue. This is a rebuttable risk if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition. We will consider the risk factors set out in ISA240 and the nature of the revenue streams at the Council to determine whether there is a risk of fraud from revenue recognition.
- The risk of management over-ride of controls is present in all entities. The need to achieve a particular financial outturn could potentially place management under undue pressure in terms of how they report performance.

Valuation of land and buildings – The Council is required to revalue its land and buildings on a sufficiently frequent basis to ensure that the carrying value in the financial statements it not materially difference from the current value at the financial statements date. To achieve this, the Council requests valuations from its valuation experts. This valuation represents a significant estimate by management in the financial statements due to the value involved and the sensitivity of this estimates to changes in key assumptions. It is expected that the valuation of land and buildings will continue to be identified as a significant risk in 2022/23. We are aware that the Council has changed its approach to the valuation of its asset base this year and has valued fewer assets than it has in previous years. We are content with the approach being applied provided that management can evidence, for those assets not valued, there is appropriate consideration ad evidence to support that their carrying value is not materially misstated.

Valuation of the local government pension fund net liability - the Council's pension fund net liability, as reflected in its balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements. The estimate is highly sensitive to changes in key underlying assumptions, such as discount and mortality rates, and these assumptions are subjective and require input from specialist actuaries on an annual basis. It is expected that the valuation of the net pension liability will continue to be identified as a significant risk in 2022/23. Furthermore, we note from receipt of the draft accounts, and from planning discussions with the finance team that due to a significant reduction in the present value of the scheme liabilities that no net pension liability is being recognised this year. We will need to undertake additional procedures to review the process applied in coming to this determination.

All of the above areas were also identified as significant risks for our 2021/22 financial statements audit.

Informing the audit risk assessment

To inform our planning we have completed a paper setting out responses from management to a series of questions posed across the themes of fraud, laws and regulations, going concern, related parties and accounting estimates. This is considered in a separate agenda item.

Financial Statements Audit 2022/23 (cont.)

Other expected areas of focus

- **Expenditure recognition** - in line with the Public Audit Forum Practice Note 10, in the public sector, auditors must also consider the risk that material misstatements due to fraudulent financial reporting may arise from the manipulation of expenditure recognition (for instance by deferring expenditure to a later period). As most public bodies are net spending bodies, then the risk of material misstatement due to fraud related to expenditure recognition may in some cases be greater than the risk of material misstatements due to fraud related to revenue recognition.
- In 2021/22, having considered the nature of the expenditure streams of the Council, we determined that there was no significant risk of material misstatement arising from improper expenditure recognition. We will revisit this assessment for 2022/23 but anticipate a consistent outcome.
- **Completeness of non-pay expenditure** - non-pay expenses on other goods and services also represents a significant percentage of the Council's operating expenses. Management uses judgement to estimate accruals of un-invoiced costs. Management also undertake an assessment of the levels of grant income received in the financial year to be deferred to future years based on the specific terms and conditions of funding. We therefore anticipate completeness of non-pay expenses being identified as a risk requiring particular audit attention.
- **Council dwellings** - in 2021/22 we reported that the Council used the housing price index to uplift house prices using indices at February 2022 with an estimate for March 2022. We were satisfied from our analysis that using February indices instead of March did not materially impact the valuation and were satisfied that the estimate was reasonable. We were aware of the timings needed in order to produce valuations and the valuer at the time did use the most up to date information with an estimate of movement made for March 2022 which wasn't available at that time. We recommended that valuations determined using estimates are revisited when actuals are known, to provide additional assurance that there is no material misstatement. We will ensure that this has taken place, where applicable in respect of the year ended 31 March 2023.
- **Annual Governance Statement** - we reported that we considered the Council's Annual Governance Statement to be 'light' in comparison to other examples we see in the sector. While we concluded it meets requirements the Council should consider enhancing its narrative for future years to more fully explain its governance arrangements, especially in light of governance failures elsewhere in the public sector. We reviewed the draft Annual Governance Statement before it was published, and are satisfied that the content is enhanced in response to our recommendation, though it is still subject to full audit procedures as at the time of writing.
- **IT control deficiencies** - we continued to report during 2021/22 that there were 4 i-Trent users with a combination of administration and financial privileges, which creates a risk that system-enforced internal controls can be bypassed. This could lead to unauthorised changes being made to system parameters, creation of unauthorised accounts, or the deletion of audit logs or disabling logging mechanisms. We note that we also reported 2 Unit 4 users with similar privileges, but the Council responded that these users need the access given in order to facilitate the smooth running of systems and processes that the Council has in place. We will follow up on these matters during 2022/23 and design our audit procedures accordingly to take these findings into account. We will follow up on these matters during 2022/23 and design our audit procedures accordingly to take these findings into account.

Value for Money 2022/23

As part of our planning work, we will consider whether there are any risks of significant weakness in the body's arrangements for securing economy, efficiency and effectiveness in its use of resources that we need to perform further procedures on. We may need to make recommendations following the completion of our work and will follow up the recommendations made in our 2022/23 Auditor's Annual Report.

Risks of significant weakness

We have not yet undertaken our planning assessment, and therefore cannot confirm the risks we will be considering.

However, we anticipate following up on any recommendations to be reported from our 2021/22 review relating to financial sustainability and improving economy, efficiency and effectiveness.

Potential types of recommendations

A range of different recommendations could be made following the completion of work on risks of significant weakness, as follows:



Key recommendation

The Code of Audit Practice requires that where auditors identify significant weaknesses in arrangements to secure value for money they should make recommendations setting out the actions that should be taken by the body. We have defined these recommendations as 'key recommendations'.



Improvement recommendation

These recommendations, if implemented should improve the arrangements in place at the body, but are not made as a result of identifying significant weaknesses in the body's arrangements

Audit logistics and team



Grant Patterson, Key Audit Partner

Grant will be the main point of contact for officers and committee members. He will share his wealth of knowledge and experience across the sector providing challenge and sharing good practice, ensuring that our audit is tailored specifically to the Council. Grant is responsible for the overall quality of our audit work, and will sign your audit opinion.



Nic Coombe, Senior Manager

Nic will work with senior members of the finance team, ensuring that any issues that arise are addressed on a timely basis. She will attend Governance and Audit Committee and liaison meetings with Grant, undertake reviews of the team's work and ensure that our reports are clear, concise and understandable.



Will Howard, Manager

Will will work directly with the finance team and manage the day-to-day work of the more junior members of our audit team. He will complete work on the more complex areas of the audit, and will provide support to Nic as necessary.

Audited body responsibilities

Where audited bodies do not deliver to the timetable agreed, we need to ensure that this does not impact on audit quality or absorb a disproportionate amount of time, thereby disadvantaging other audits. Where the elapsed time to complete an audit exceeds that agreed due to a client not meeting its obligations we will not be able to maintain a team on site. Similarly, where additional resources are needed to complete the audit due to a client not meeting their obligations we are not able to guarantee the delivery of the audit to the agreed timescales. In addition, delayed audits will incur additional audit fees.

Our requirements

To minimise the risk of a delayed audit, you need to ensure that you:

- produce draft financial statements of good quality by the agreed timetable you have agreed with us, including all notes, the Narrative Report and the Annual Governance Statement
- ensure that good quality working papers are available at the start of the audit, in accordance with the working paper requirements schedule that we have shared with you
- ensure that the agreed data reports are available to us at the start of the audit and are reconciled to the values in the accounts, in order to facilitate our selection of items for testing
- ensure that all appropriate staff are available on site throughout (or as otherwise agreed) the planned period of the audit
- respond promptly and adequately to audit queries.

Audit fees and updated Auditing Standards including ISA 315 Revised

In 2017, PSAA awarded a contract of audit for Leicester City Council to begin with effect from 2018/19. The fee agreed in the contract was £109,997. Since that time, there have been a number of developments, particularly in relation to the revised Code and ISA's which are relevant for the 2022/23 audit. For details of the changes which impacted on years up to 2021/22 please see our prior year Audit Plans.

The major change impacting on our audit for 2022/23 is the introduction of ISA (UK) 315 (Revised) - Identifying and assessing the risks of material misstatement ('ISA 315'). There are a number of significant changes that will impact the nature and extent of our risk assessment procedures and the work we perform to respond to these identified risks. Key changes include:

- Enhanced requirements around understanding the Council's IT Infrastructure, IT environment. From this we will then identify any risks arising from the use of IT. We are then required to identify the IT General Controls ('ITGCs') that address those risks and test the design and implementation of ITGCs that address the risks arising from the use of IT.
- Additional documentation of our understanding of the Council's business model, which may result in us needing to perform additional inquiries to understand the Council's end-to-end processes over more classes of transactions, balances and disclosures.
- We are required to identify controls within a business process and identify which of those controls are controls relevant to the audit. These include, but are not limited to, controls over significant risks and journal entries. We will need to identify the risks arising from the use of IT and the general IT controls (ITGCs) as part of obtaining an understanding of relevant controls.
- Where we do not test the operating effectiveness of controls, the assessment of risk will be the inherent risk, this means that our sample sizes may be larger than in previous years.

These are significant changes which will require us to increase the scope, nature and extent of our audit documentation, particularly in respect of your business processes, and your IT controls. We will be unable to determine the full fee impact until we have undertaken further work in respect of the above areas. However, for an authority of your size, we estimate an initial increase of £5,000. We will let you know if our work in respect of business processes and IT controls identifies any issues requiring further audit testing. There is likely to be an ongoing requirement for a fee increase in future years, although we are unable yet to quantify that.

The other major change to Auditing Standards in 2022/23 is in respect of ISA 240 which deals with the auditor's responsibilities relating to fraud in an audit of financial statements. This Standard gives more prominence to the risk of fraud in the audit planning process. We will let you know during the course of the audit should we be required to undertake any additional work in this area which will impact on your fee.

Taking into account the above, our proposed work and fee for 2022/23, as set out below, is detailed overleaf.

Audit fees

	Actual Fee 2020/21	Actual Fee 2021/22	Proposed fee 2022/23
Leicester City Council Audit	£173,734	£173,447	£176,947
Total audit fees (excluding VAT)	£173,734	£173,447	£176,947

Assumptions

In setting the above fees, we have assumed that the Council will:

- prepare a good quality set of accounts, supported by comprehensive and well-presented working papers which are ready at the start of the audit
- provide appropriate analysis, support and evidence to support all critical judgements and significant judgements made during the course of preparing the financial statements
- provide early notice of proposed complex or unusual transactions which could have a material impact on the financial statements.

Relevant professional standards

In preparing our fee estimate, we have had regard to all relevant professional standards, including paragraphs 4.1 and 4.2 of the FRC's [Ethical Standard \(revised 2019\)](#) which stipulate that the Engagement Lead (Key Audit Partner) must set a fee sufficient to enable the resourcing of the audit with partners and staff with appropriate time and skill to deliver an audit to the required professional and Ethical standards.

Audit fees – detailed analysis

Scale fee published by PSAA for 2022/23	128,947
(This includes ‘baked-in’ increases from previous years which continue to apply for future years in relation to:	
• £4,375 pension valuations	
• £5,438 for PPE valuations	
• £6,250 for additional FRC challenge	
Continued impact in relation to decreased materiality	£3,750
Impact of ISA540	£6,000
Enhancements to journals testing	£3,000
Increased audit requirements for ongoing raising of quality standards - FRC	£1,500
Infrastructure	£2,500
Appointment of auditor’s expert in respect of PP&E valuations	£5,000
Enhanced audit procedures for Payroll – Change of circumstances	£500
Enhanced audit procedures for Collection Fund - reliefs testing	£750
Increased audit requirements of revised ISAs 315	£5,000
Additional work on Value for Money (VfM) under new NAO Code	£20,000
Total proposed audit fees 2022/23 (excluding VAT)	£176,947

All variations to the scale fee will need to be approved by PSAA



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