National Audit Office

NAO reflections on 2019-20 and beyond

Presentation to FRAB 19 November 2020

November 2020

Introduction 1

This presentation focuses on our findings and reflections on the 2019-20 accounts and audit cycle. We are aware for some preparers this is still an ongoing cycle. Last year was the first year we brought the themes of the previous audit cycle to the Finance Leadership Group and FRAB; here, we build on this.

This year has been significantly shaped by COVID-19. Here, we reflect on the financial reporting and audit impact. We also want to keep a wider perspective and return to the themes we identified last year, as these remain relevant and are not related to COVID-19.

This presentation covers:

- Reflecting on 2019-20: Headlines
- The profile of 2019-20 certifications
- Response to COVID-19
- Financial controls and financial management
- Financial reporting
- Our priorities - Looking ahead to 2020-21
- Our priorities - IFRS 16
- Working together in 2020-21

Introduction 2

Our work to promptly audit and certify high quality financial statements is reliant on working in partnership with HM Treasury and finance teams across central government.

In this presentation we make a number of suggestions as to where changes could be made in 2020-21.

We would welcome the opportunity today to have a conversation about how we take these forward.

Questions we would appreciate FRAB's views on at the end:

- Your own reflections on 2019-20?
- How our priorities align to those of FRAB in 2020-21?

Reflecting on 2019-20: Headlines

Thank you! It has been a challenging year for everyone in work and away from it. Your engagement and commitment has been vital. We recognise the enormous effort that has been required from you and your teams. For those of you still working to get accounts laid before Parliament, we are working with you to get these done as soon as possible.

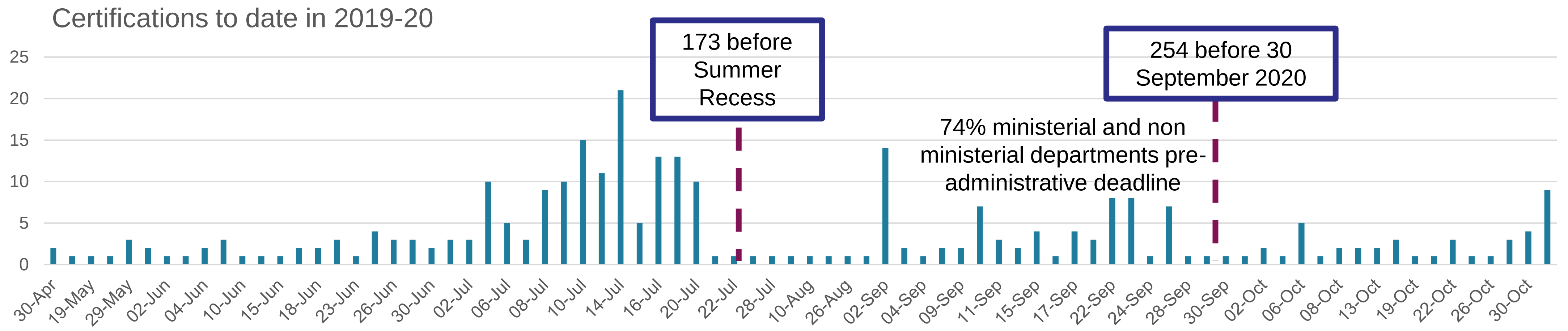
When we all moved to remote working in March, the concept of delivering accounts and audits remotely was untested. Delivering accounts and audits remotely, supported by technology and active engagement on both sides, has worked well.

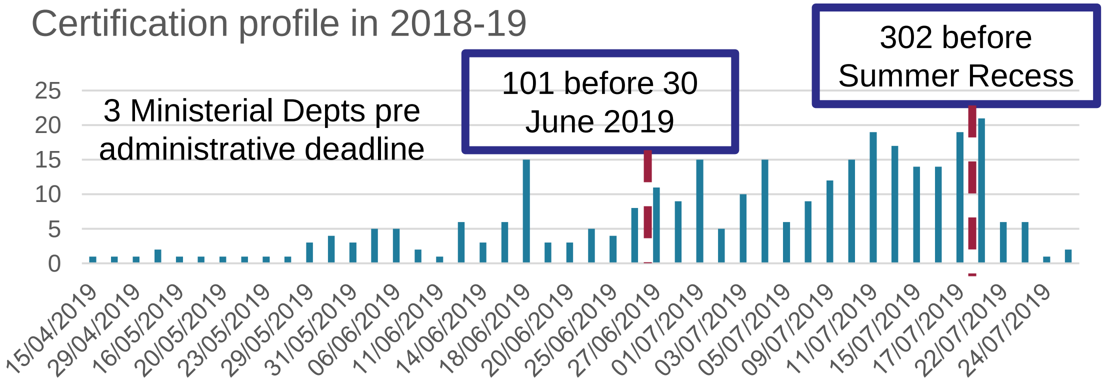
COVID-19 has had a significant impact on financial statement preparation and audit opinions. We had to recognise new significant audit risks or enhance procedures against risks already identified. These primarily related to balance sheet valuations. Focus on these areas is driven by the requirements of the accounting framework and auditing standards and supports accountability and transparency over the impact on valuations at year end.

In 2019-20 we have issued 69 emphases of matter. This compares to 16 in 2018-19. This scale of modifications relates to uncertainties associated with the pandemic. The increase in emphases of matter mainly apply to balance sheet items where the valuation of the estimate has significant estimation uncertainty in the climate that existed at 31 March 2020. Others have arisen due to going concern uncertainty.

The year also saw the highest number of excess votes we have seen for many years. Of the 5, only 2 were related to new COVID-19 expenditure.

The profile of 2019-20 certifications





HM Treasury's action to move the administrative deadline to September allowed for more realistic re-planning of timetables. The majority of Departments hit the revised target. We support a tailored approach to 2020-21 cycle, acknowledging it will take more than a year to return to the kind of certification profile we saw in 2018-19.

Timetables for 2019-20 moved back for a variety of reasons: capacity impact of COVID-19; new financial reporting risks arising from COVID-19; delays in getting evidence to support balances, including from LGPS pensions; and challenge of new ways of operating virtually.

Response to COVID-19: 1

COVID-19 presented challenges to both financial reporting and audit, the areas most significantly impacted were:

- **Capacity impacts:** Operational demands, including support for COVID-19 response and redeployment of people, the move to remote working, and impact on people (e.g. caring responsibilities, home schooling) placed significant strain on finance teams, with similar impacts on audit teams. We witnessed the fantastic commitment of your teams to respond.

- **IFRS 9 expected credit losses:** COVID-19 presented a challenge to expected credit loss modelling and resulted in increased impairments. Uncertainty over the macroeconomic impact tested the approach in place as well as the data available for determining expected credit losses. In some cases, a fundamental level of uncertainty required us to include an emphasis of matter in our audit opinion.

- **Property Valuations:** Driven by a lack of information to support valuations at 31 March, professional valuations were regularly accompanied by material uncertainty clauses. This applied broadly to government property assets including those carried at depreciated replacement cost. It required careful assessment and resulted in many emphases of matter.

- **Going Concern:** COVID-19 brought significant future funding challenges to many organisations relying on income aside from grant in aid, notably charities. In some cases evidence of government support was necessary to underpin a going concern assessment. The timing - in the middle of a spending review – added more complexity.

Response to COVID-19: 2

COVID-19 presented challenges to both financial reporting and audit, the areas most significantly impacted were:

Fraud and error in schemes: We identified that the expansion of existing - and the swift development of new - schemes as part of the COVID-19 response, led to greater fraud and error risks. The more significant impact of this will more be seen in 2020-21.

New liabilities and announcements of COVID-19 financial support measures: the announcements made in March 2020, just ahead of year end caused some additional liabilities to be crystallised which needed to be assessed for both recognition and valuation. This led to extensive post balance sheet event disclosure. In parallel to the work auditing the financial statements, we advised PAC on 14 Ministerial Directions arising in relation to COVID-19.

Stock takes and asset verification: Many stock takes and asset verification exercises couldn’t take place at year end. In many, but not all, cases we were able to undertake alternative procedures. Alternative procedures were enabled through the use of technology or evidence from alternative dates, supplemented by analytical procedures.

Support to preparers: Government finance function identified similar financial reporting and audit risks associated with the COVID-19 pandemic and issued supporting communications to the profession.

Response to COVID-19: 3

COVID-19 presented challenges to both financial reporting and audit, the areas most significantly impacted were:

Timetables: HM Treasury's response to the pandemic eased the burden on preparers. The key changes were moving the administration deadline to 30 September 2020, as well as postponing the implementation of IFRS 16. We supported these measures. We saw excellent examples of appropriately recalibrating project plans but also cases where the true implications were not grasped until late on in the process and significant slippage ensued. Late review and intervention on ARAs by departments, particularly in entities significantly impacted by COVID-19 created additional delays at the end of the process.

Maintaining controls: Business continuity plans were enacted effectively. Technology and systems stood up well to the requirements of remote working, and operating existing "business as usual" controls remotely. We identified examples of controls working well under pressure at year end

Disclosures: We saw good transparency around Ministerial Directions in ARAs and some excellent disclosures considering the risks COVID-19 presents to the organisation

Financial management and financial controls

Balance sheet reconciliations remain an area of weaknesses. Some entities are not conducting these to a sufficient quality or frequency. Bank and balance sheet reconciliations should be undertaken and reviewed as standard each month. Aged reconciling items should be investigated and cleared.

Administrative and spreadsheet errors resulted in several excess votes in year. We would expect the underlying data sources being used to populate Estimate requests to be carefully reviewed before being submitted and the Supplementary Estimate to provide and additional opportunity to check the submission to date. Errors in Estimates submissions can be highly visible as there is no opportunity to correct them where an excess is subsequently incurred and leads to qualification. We also continue to identify errors in models providing accounting estimates leading to audit adjustments and are working with departments to promote best practice over model governance and controls.

We found mixed levels of engagement and oversight between departments and their Arms Length Bodies. We encourage an ongoing conversation between the two throughout the year, particularly relating to budgets, approvals under the framework documents, financial reporting issues arising and the implementation of new accounting standards.

Financial reporting: 1

Application of IFRS 9, including disclosure requirements, particularly regarding expected credit loss assessments, continues to be challenging for finance teams and in some cases required specialist support With accounting standards becoming more demanding in some areas the specialist support and centres of expertise in finance teams should be developed to match this.

There remains scope to streamline accounts disclosures. However, we also found instances of disclosures on matters of key interest to be based on minimum compliance, rather than good practice and transparency. Revisions to IAS 1 for 2020-21 focus on prominent disclosure of material items using clear language, in one place.

We identified delays in laying accounts post certification which, in some cases, resulted in even greater delays as relevant announcements made in this window required evaluation and potentially new disclosure. We recommend laying accounts as soon as possible post certification.

Financial reporting: 2

Performance reporting varied considerably. One of the challenges to this is linking into the Single Departmental Plan (SDP) where this is out of date or at a high level
2019-20 provided some specific challenges in this area but we would welcome a discussion on how Departments can continue to improve reporting in this area.

The *Corporate Governance Code for Central Government Departments: Code of good practice* indicates boards should meet at least quarterly, we have identified many departments meeting fewer than four times a year, with some meeting only once
We would expect boards to be meeting at least four times a year and in light of the current challenges, departments may wish to consider whether this should be more frequently

Our priorities - Looking ahead to 2020-21

COVID-19 brings increased financial reporting and audit risks in 2020-21. A focus for us are the new schemes set up in 2020-21, with the associated new controls, risk of fraud and an increase in balance sheet valuation risk. Through our engagement with you on the COVID-19 response we are well placed to understand these areas of risk.

We expect to perform a very significant proportion of audit work remotely for 2020-21. We will build on the learning from 2019-20. We will focus on how to co-ordinate more effectively with you on the best means of working, as well as the timing of work, both for 2020-21. We will also consider where there are benefits over the longer term.

We are working on our plans for 2020-21. Our priority is timely accountability where this can be supported by quality reporting and audit. The COVID impact on timetables will extend beyond one cycle for some bodies. Where you have realistic plans to prepare and lay accounts pre summer recess we will support you in these.

EU Exit will also shape our risk assessments. Much of our focus will be on the COVID-19 impacts in 2020-21, however EU Exit will also be important. We will need to consider the impact of the end of the transition period.

New auditing standards in 2020-21. Changes to the standards on auditing accounting estimates and going concern apply from 2020-21. The audit requirements are more demanding and will give rise to changes in our information requests and audit approaches in some cases. Required changes include greater focus on use of auditor's experts and understanding contradictory evidence.

Our priorities - IFRS 16

We have audited the transition and now the full implementation of IFRS 16 in early adopting departments and through our companies audits portfolio. The following are the lessons learned we have identified:

Planning

- **Don't underestimate the amount of work involved.** You'll need a project plan with buy-in from key stakeholders.
- Timetable IFRS 16 into the accounts preparation process including early preparation and review.

People

- **Many leases are held and managed locally, outside the finance team.** You will need to talk to all divisions to identify them. This is not a one off interaction - you will need to engage over the life of the leases.
- Establishing a point of contact, to provide expert advice, within the finance team helps.
- Consider whether you need specialist support to review, calculate or make judgements about the leases.

Review in Finance

- **Consider what training, including refresher training, is required for key finance people.**
- Review the adaptations and interpretations for IFRS 16 in the FReM and the guidance provided by HMT early and consider how these apply to your population of leases.
- Review the outcomes from black box models carefully. Sense check inputs being provided by divisions. Ask yourselves if accounting judgements, e.g. on lease terms, are in line with business decisions.