In-depth insight into the impact of Covid-19 on financial reporting in the local government sector

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Introduction

Local authorities across the country are now working in an environment that is completely different to the one they were in just months ago as the Covid-19 pandemic continues to impact their daily operations. In such uncertain times, now more than ever communities will be looking towards local authorities to do what they do best, providing essential local public services and particularly care and support to the most vulnerable members of our society.

The virus and measures taken to contain it have undoubtedly impacted financial and economic activity and the effects will not be contained to the 2019/20 and 2020/21 financial years but will be felt for a considerable time. This has several ramifications that local authorities will need to carefully consider in preparing and finalising their 2019/20 Narrative Report, financial statements and Annual Governance Statement.

For the year end 31 March 2020, effects of Covid-19 will need to be taken into account in measuring assets and liabilities at the balance sheet date. There may also be additional, non-adjusting, post balance sheet events relating to the ongoing pandemic that require disclosure in 2019/20 financial statements. For those local authorities yet to conclude their financial statements for years prior to 2019/20, the emergence of new information about Covid-19 and its impact is a non-adjusting post balance sheet event requiring disclosure in those financial statements.

The aim of this report is to help officers and elected members identify points they should consider when assessing and reporting the impact of Covid-19 on their authority. Each authority will be impacted in different ways and will need to make their own assessment of the impact on their financial statements. However, we have identified some of the key challenges for the sector, along with the potential financial reporting and regulatory impact, to support preparers of local authority accounts navigate through some of these key issues. We have also included a number of useful links to other resources.

Executive summary

As a nation we are likely to feel the societal and financial consequences of the Covid-19 pandemic, and the measures to contain and mitigate its effects, for years, and possibly decades, to come.

The extraordinary events we are living through follow a decade of austerity, triggered by the financial crisis of 2008/09, which had already placed considerable strain on local authorities' finances. Increased demand for many local public services, directly related to the outbreak of the virus, has placed immediate pressure on authorities' cash flows and expenditure budgets. The longer-term consequences of recession and unemployment on demand for services have yet to be experienced.

At the same time, several important sources of local authority income including Council Tax, Non-domestic (business) rates, fees and charges, rents and investment returns have, to a greater or lesser extent, been subject to reduction or suspension. This perfect storm of conditions presents a real threat to the financial sustainability of the sector. Now, more than ever, strong political and executive leadership is needed to re-establish priorities, review strategies and medium-term financial plans and ensure that public funds are being used as efficiently and effectively as possible. A balance has to be struck between responding to the needs of residents and businesses in a timely manner, protecting the most vulnerable and ensuring appropriate measures and controls around financial management are in place to mitigate against future 'financial shock'. In doing so, iterative scenario planning will help officers and elected members to take informed decisions at key stages, revisiting and revising plans along the way. Grant Thornton's 'Financial Foresight' model, developed in collaboration with CIPFA, can help local authorities bring together future spend forecasts with future income streams and combine this with placed based data to reflect the impact of local demographic and economic changes. Narrative reports, as presented in local authorities' statements of accounts, provide an important platform to communicate key information relating to the external environment, risks and opportunities, financial outlook and plans for dealing with potential budget shortfalls. Within the report we explore key considerations for local authority Narrative reports arising from the pandemic.

Local authorities hold a wide range of statutory and non-statutory receivables, including Council Tax and Non-domestic rate debtor balances, trade receivables, loans receivable and bank balances. Measures taken to control Covid-19 are leading to heavy economic losses and this has and will continue to affect collection rates, as some individuals and businesses experience financial effects of the pandemic. In preparing financial statements authorities will need to consider the recoverability of debt and the potential need to recognise impairments.

The uncertainties created by the pandemic have also significantly increased volatility and uncertainty in markets. In this environment it is important to maintain regular dialogue with management experts where they have roles in relation to asset valuations used in the preparation of accounts. This applies not only to non-current operational and non-operational property assets held by authorities, but also to investment properties, financial assets and many assets held by pension funds. Additional disclosures in financial statements in relation to major sources of estimation uncertainty may prove to be necessary.

We hope that you find our report insightful and helpful in preparing your accounts in this new reality.

Operational challenges and the related financial reporting/regulatory impact

Operational challenge	Related financial reporting/regulatory impact
Increase in demand from service recipients both in the short and long-term	**Financial sustainability and use of reserves** – This is clearly a significant challenge for the majority of local authorities. Ten years of austerity has severely stretched finances across the sector, leaving many with depleted reserves as they seek to manage the delicate balancing of demand-led pressures and available resources. The challenges associated with Covid-19 are unprecedented in modern times and as well as increasing demand for a wide range of services including adult social care, children's social care, services for the homeless, public health and support for the vulnerable it resulted in immediate pressures on local authority cash flows. The pandemic has heightened uncertainty and will continue to impact into the longer term. Local authorities want to support service recipients as best as they can, however it is essential to consider long-term financial sustainability and ensure that reserves are not depleted to levels that put authorities in danger of insolvency. Priorities need to be established, and kept under review, and strategies will need to be re-worked to ensure that funds are being used as efficiently and effectively as possible. In doing so, iterative scenario planning will help officers and elected members to take informed decisions at key stages, revisiting and revising plans along the way. In extreme circumstances some local authorities may be considering issuing notices under s114 of the Local Government Finance Act 1988. A s114 notice can have serious operational implications, including bringing a halt to all non-statutory expenditure, potentially hindering the response to the pandemic. The Ministry of Housing Communities and Local Government (MHCLG) has urged any local authorities with serious concerns about its financial sustainability to approach the department in the first instance. Local authorities are required to publish a narrative report with the financial statements, providing information on the authority (including any group interests), its main objectives and strategies and the principal risks it faces. The impact of the pandemic will need to be taken into account in drafting the 2019/20 report and further commentary on the issues which may need to be addressed is included on page 13 of this report.

Operational challenge	Related financial reporting/regulatory impact
Reduction in key sources of income	**Impairment of statutory and non-statutory debt** – At the same time as responding to new challenges in providing vital public services, local authorities are also faced with a significant squeeze on several of their sources of income. Income from fees and charges, rental income, returns on investments including interest and dividends have all been affected to a greater or lesser degree, with significant uncertainty over the timing and extent to which these sources of income will return to pre-Covid-19 levels. Measures taken to control the pandemic are leading to heavy economic losses and most large economies will see unprecedented falls in economic output. Increasing levels of unemployment and reducing tax revenues associated with global recession will affect collection rates for Council Tax and Non-domestic rates as individuals and businesses experience the financial effects of the pandemic, resulting in further pressure on authorities' cash flows and finances. In preparing 2019/20 financial statements, authorities will need to take into account the potential for impairment of statutory Council Tax and Non-domestic rate debtor balances. Assessment of impairment needs to take place for both individually significant debtors, and also collectively for balances that are not individually significant. Observable data indicating a measurable decrease in estimated future cashflow, for example an increase in the number of delayed payments, should be taken into account. Recent historical loss experience across aged debt may also need revision where current information indicates the historical experience doesn't reflect current conditions. Experience following the 2008/09 financial crisis may prove to be a useful reference point, given the ensuing recession conditions. IFRS 9 *Financial Instruments* is adopted by the Code of Practice on Local Authority Accounting ('the Code') and includes a three-stage impairment model which is applicable to financial assets including trade receivables, loan receivables, deposits and other debtors. IFRS 9 requires that forward-looking information (including macro-economic information) is considered both when assessing whether there has been a significant increase in credit risk and when measuring expected credit losses. The Covid-19 pandemic is likely to have caused significant deterioration in the credit quality of some businesses – this clearly varies from sector to sector with, for example, the hotel industry more severely affected than say the grocery sector. Authorities should re-assess expected credit losses in light of the pandemic, as the probability of losses occurring is likely to have increased.

Operational challenge	Related financial reporting/regulatory impact
Closure of local authority offices, premises and facilities	**Valuation of non-current assets** – The Code requires that where assets, including Council dwellings and operational land and buildings, are revalued to 'current value' the revaluations shall be sufficiently regular to ensure that carrying amounts do not differ materially from current value at the end of the reporting period. Surplus assets and investment properties are required to be measured at fair value, reflecting market conditions at the end of the reporting period. We note a significant increase in volatility and uncertainty in markets following the outbreak of Covid-19. RICS has issued a Valuation Practice Alert following the pandemic, and we are aware a significant number of valuers are including 'material valuation uncertainty' disclosures within their reports. Our expectation is that authorities will assess the impact of such comments, taking account of the requirement of Code paragraph 3.4.2.90 to provide appropriate disclosure in their financial statements in relation to major sources of estimation uncertainty. Where such comments are included in management's experts' reports, and appropriate disclosure is correspondingly included within financial statements, auditors are likely to consider the need to include an 'emphasis of matter' paragraph within their audit report. An emphasis of matter paragraph is not a qualification or modification of the auditor's report. It is used to draw the reader's attention to a matter that has been appropriately presented or disclosed in the financial statements and which, in the auditor's judgement, is of such importance that it is fundamental to the users' understanding of the financial statements. **Onerous leases and other onerous contracts** – It is uncertain as to when the lockdown restrictions may be lifted and when local authority premises can feasibly re-open, due to availability of staff and ability to implement required social distancing measures. Where premises are not owned but are being rented, authorities will need to consider the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received and whether an onerous lease provision is required. This is equally applicable to other contracts the authority might have where, especially due to the pandemic, the unavoidable costs of meeting their obligations under the contract exceed the economic benefits expected to be received under it. See section 8.2 of the Code for further detail. **Inventories** – Authorities will need to consider whether at the reporting date the value of any stock needs to be written down, particularly for items which may not be used within their shelf-lives or other conditions which might make them unusable or mean they have a reduced value when lockdown restrictions are eased.

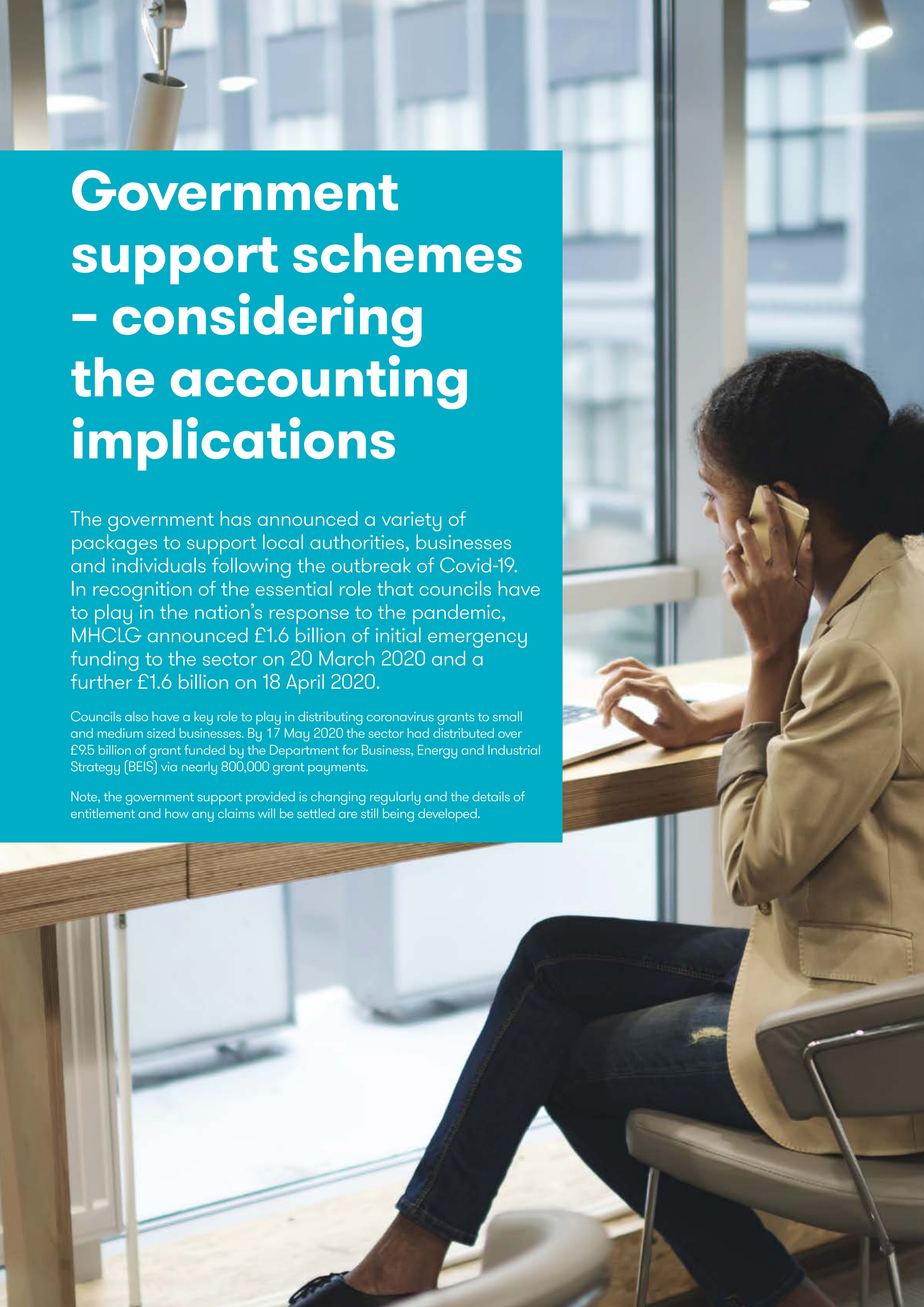
Operational challenge	Related financial reporting/regulatory impact
Pausing significant projects	**Capital projects** – In applying the Code, authorities capitalise directly attributable costs of items of property, plant and equipment as an asset on the Balance Sheet if and only if it is probable that future economic benefits or service potential associated with the item will flow to the authority and the cost can be measured reliably. Costs relating to schemes that are discontinued or abortive costs should be excluded from capitalisation. An authority will capitalise expenditure while it is reasonably assured that operative property, plant and equipment will eventually be constructed or acquired. This expenditure could remain on the balance sheet even while work on a scheme is suspended, provided that the outcome of the expenditure to date can be mothballed and there is sufficient certainty that the scheme will be reactivated within a reasonable timescale. Where an authority is not reasonably assured that a scheme will proceed, costs should be written off within service expenditure in the comprehensive income and expenditure statement. **Grant income** – For any grants received or due to be received, local authorities may need to re-assess whether they can fulfill the performance measures or requirements of the grants, particularly where the activities have had to be adapted to the current circumstances and resources re-allocated. These might include achieving certain levels of output or using the grant within a specified time period, which may no longer be possible. The Code adapts IAS 20. Grants and contributions are required to be recognised as income, except where an authority has not complied with any attached conditions. If funding bodies make changes to the conditions set out in existing agreements then authorities will need to re-assess the recognition of grants in the financial statements.
Managing cashflow to meet liabilities as they fall due	**Going concern** – The Code requires local authorities, that can only be discontinued under statutory prescription, to prepare their financial statements on a going concern basis. The international financial reporting framework on which the Code is based still requires disclosure of material uncertainties related to events or conditions that may cast significant doubt upon entities ability to continue as a going concern. In view of the Covid-19 pandemic, and pressures on local authority finances, consideration of this requirement will come into sharper focus in audits of 2019/20 financial statements and further commentary on the issues which may need to be addressed is included on page 14 of this report

Government support schemes – considering the accounting implications

The government has announced a variety of packages to support local authorities, businesses and individuals following the outbreak of Covid-19. In recognition of the essential role that councils have to play in the nation's response to the pandemic, MHCLG announced £1.6 billion of initial emergency funding to the sector on 20 March 2020 and a further £1.6 billion on 18 April 2020.

Councils also have a key role to play in distributing coronavirus grants to small and medium sized businesses. By 17 May 2020 the sector had distributed over £9.5 billion of grant funded by the Department for Business, Energy and Industrial Strategy (BEIS) via nearly 800,000 grant payments.

Note, the government support provided is changing regularly and the details of entitlement and how any claims will be settled are still being developed.



Government scheme	Accounting considerations
Covid-19 emergency funding for local government MHCLG made available emergency funding to support local authorities in meeting increased demand for adult social care, children's social care, additional support for the homeless and those at higher risk of severe illness from Covid-19. Initial funding of £1.6 billion was announced on 20 March and paid prior to the end of the 2019/20 financial year, on 27 March. An additional £1.6bn was announced early in the 2020/21 financial year, on 18 April.	**Government grants** In line with the Code, Government grants represent "assistance in the form of transfers of resources to an authority in return for past or future compliance with certain conditions relating to the operation of activities." Section 2.3 of the Code sets out the required accounting treatment for government grants. Government grant income should be recognised when there is reasonable assurance that the recipient authority will comply with attached conditions and that the grant will be received. The government has confirmed that this emergency funding has been provided on an un-ringfenced basis and as such it should be credited to the comprehensive income and expenditure statement as income immediately in the relevant financial year, in accordance with 2.3.2.9 of the Code. Authorities should also note the disclosure requirements set out at 2.3.4.
Covid-19 grants to small and medium businesses In the Budget delivered to Parliament on 11 March 2020, the Chancellor announced all businesses eligible for Small Business Rates Relief and Rural Rates Relief would receive a grant of £3,000 to help with the impact of Covid-19. Subsequently the scheme was expanded to include businesses in the retail, hospitality and leisure sectors and the amount of grant increased to £10,000 for businesses with a rateable value under £15,000 and to £25,000 for businesses with a rateable value between £15,000 and £51,000. On 1 May BEIS announced a Local Authority Discretionary Grants Fund, aimed at small and micro businesses not eligible for the earlier schemes, with funding of up to 5% of the small businesses and retail, hospitality and leisure schemes available.	**Principal and agent transactions** The eligibility criteria for these schemes are set out in government guidance and local authorities which are billing authorities are required to use their business rates information system to identify the properties that meet the eligibility criteria and pay over the grants to businesses. Local authorities are reimbursed by government for the grant payments made using a grant under section 31 of the Local Government Act 2003. Billing authorities will need to assess whether they should be accounting for the s31 grants paid to them by BEIS and the distribution of the grants to eligible businesses, as either principal or agent transactions in accordance with Section 2.6 of the Code and the principles set out in paragraphs B34-B38 of IFRS 15. Where billing authorities have no control over the amount to be awarded, there is no mandatory application process, eligibility is related to business status and billing authorities only have discretion not to award the grant until they identify the correct recipient then these features may indicate that authorities are not acting on their own behalf, but as agents of BEIS. Paragraph 2.6.2.4 of the Code requires that where an authority acts as an agent, transactions will not be reflected in an authority's financial statements, with the exception in respect of cash collected or expenditure incurred by the agent on behalf of the principal. In these cases a debtor or creditor will be recognised and the net cash position included in financing activities in the cash flow statement.

Government scheme	Accounting considerations
Expanded Retail Discount – 100% business rates relief In response to the coronavirus pandemic, in the Budget on 11 March the Government announced that it would increase the Business Rates Retail Discount to 100% for 2020/21 and extend it to include the leisure and hospitality sectors. Following the announcement on 23 March 2020 of further measures to limit the spread of coronavirus, the Government confirmed that some of the exclusions for this relief have been removed, so that retail, leisure, and hospitality properties that have had to close as a result of the restriction measures will now be eligible for the relief.	**Collection Fund** The collection fund statement is an agent's statement that reflects the statutory obligation for billing authorities to maintain a separate fund in accordance with Section 89 of the Local Government Finance Act 1988. The fund shows the transactions of the billing authority in relation to the collection from taxpayers and distribution to local authorities and the government of council tax and non-domestic rates. For 2019/20 and 2020/21, we would expect non-domestic rates income credited to the Collection Fund to represent amounts receivable, net of any discretionary and mandatory reliefs. **Government grants** The Government has indicated that it will fully reimburse local authorities for the local share of the discretionary relief granted under section 47 of the Local Government Finance Act 1988 (as amended), using a grant under section 31 of the Local Government Act 2003. Local authorities will have completed their NNDR1 for 2020/21 already. Therefore, billing authorities will provide a further and separate estimate of their likely total cost for providing the 100% extended relief in 2020/21. We would expect authorities to recognise these s31 grants as a credit to General Fund via the 'Taxation and non-specific grant income' line of the Comprehensive Income and Expenditure Statement.

Significant financial reporting issues to consider

Covid-19 is likely to have a significant impact on a number of other areas:

Narrative report

Additional disclosure is likely to be required around Covid-19 in most areas of the narrative report, with particular consideration given to providing information on:

- the external environment and significant changes to services and key objectives
- any significant changes to governance arrangements as a result of lockdown controls, cross-referencing to the Annual Governance Statement where appropriate
- risks and opportunities, this could include key risks and uncertainties in relation to future service provision, including financial risks, risks arising from the financial performance of subsidiaries and investments in other entities, risk mitigation measures, the acceleration of digital access to services
- the outlook for the authority including factors that may affect future cash flows, details of known future budget pressures or changes in resources and the authority's plans for dealing with any shortfalls.

Whilst it isn't possible to predict the ultimate extent and duration of the pandemic, or its wider impact on the economy, stakeholders will to look to authorities to use best endeavors to explain the specific known impacts on their organisation to date, as well as the anticipated future impacts under different scenarios. The specific areas affected by uncertainty are discussed below in more detail, however we would expect that many authorities will have to reconsider their strategies and outlook going forward given the significant impacts of Covid-19. Further, measures to contain the pandemic have likely put pressure on governance processes and on elected members in discharging their responsibilities.

Accordingly, apart from the specific aspects of the narrative report detailed below, we would expect the report to include detailed and specific explanations of the current impact of Covid-19, how the authority has responded and the resilience of the organisation in the face of longer-term uncertainty.

Future plans and activities

This is an area which will require significant consideration by authorities as strategies are likely to have changed from those previously agreed and planned for. As noted above, whilst it isn't possible to predict the ultimate long-term impact of the virus, disclosure is required regarding the current impact as well as the anticipated future impact and how their strategies have had to change in light of the current pandemic.

Financial review and outlook

Consistency between the narrative report and amounts recorded in the financial statements, as well as the adequacy of disclosures made in the financial statements, is important. Authorities will need to ensure appropriate disclosure of material movements in amounts recorded is provided.

In line with paragraph 3.1.1.15 of the Code authorities are required to provide sufficient information to allow the reader to assess the future sustainability of the organisation including cash flows during the year and the factors that may affect future cash flows, information on the authority's key commitments and details of known future budget pressures, or changes in resources, and the authority's plans for dealing with any shortfalls.

Reserves

This is an area which is likely to be affected by the pandemic and some authorities may have to reduce their reserves to below their original target level. Authorities are required to include a description of the nature and purpose of their reserves either in the narrative report or with the financial statements themselves and additional commentary may be required in authorities' 2019/20 statement of accounts.

Risks and opportunities

Stakeholders will be especially interested in the authority's risk assessment regarding the impact of Covid-19 and the actions the authority has taken or is planning in response to the pandemic. The narrative report should include key risks and uncertainties in relation to future service provision and associated risk mitigation measures. Where there is a potential material impact on the authority's operational model or performance further details of the future outlook, risks and uncertainties should be provided. The report should be balanced and achievements and opportunities, for example in relation to rolling out digital access to the authority's services should also be addressed.

When disclosing principal risks and uncertainties, authorities should consider the specific resources, assets and relationships that are most at risk and the mitigating steps being taken to protect them. The principal risks and uncertainties would be expected to include the aspects which may be crucial to an authority's ability to withstand the various market and operational disruptions and rebuild when the opportunity arises. For example, risks and uncertainties arising from the disruption of service operation, the potential loss of key sources of income or the absence of key individuals.

Governance

The Code requires that where there have been significant changes in, or issues around, governance arrangements during the year, these should be highlighted in the narrative report. Paragraph 3.7.4.3 of the Code extends requirements in relation to the Annual Governance Statement to include significant events or developments relating to the governance system that occur between the reporting date and the date on which the statement of accounts is signed by the responsible financial officer.

Social distancing measures and staff absences are likely to have had a significant impact on authorities' governance arrangements. MHCLG laid regulations before Parliament in April 2020 to provide flexibility in relation to local authority and police and crime panel meetings held between 4 April 2020 and 6 May 2021. These regulations provide for remote access to meetings of local authorities by members of a local authority and by the press and public. The regulations also enable local authorities to hold and alter the frequency and occurrence of meetings without requirement for further notice and they disapply provisions requiring local authorities to hold annual meetings.

Given the fundamental importance of local democracy, openness and transparency, accountability and the overarching responsibility to serve the public interest we would expect authorities to describe the new arrangements they have put in place to hold meetings virtually, allow elected members to fully engage in taking key decisions and allow for public participation, within their Annual Governance Statement.

Going concern

Local authorities can only be discontinued under statutory prescription and as such should continue to prepare their financial statements on a going concern basis. In preparing their financial statements authorities are required to disclose material uncertainties related to events or conditions that may cast significant doubt upon their ability to continue as a going concern. In view of the Covid-19 pandemic and pressures on local authority finances, consideration of this requirement will come into sharper focus in audits of 2019/20 financial statements.

Going concern and any associated material uncertainties will need significant consideration and may have an impact on the audit report, narrative reporting and accounting policy disclosures in the accounts.

Some key areas to consider around going concern are:

- **Forecasting** – Forecasts will need to be revisited in light of the current circumstances and a variety of sensitivities and stress testing performed. Authorities should ensure that cash forecasts cover a period up to at least 12 months after the date of approval of the audited financial statements, and base these on cash flows. If any government support schemes are included in forecasts these should only be included up to the point that the government have committed to date.
- **Material uncertainties** – Although expected to be unusual in a local government context, paragraph 25 of IAS 1 requires that when management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern these shall be disclosed within the financial statements.

Significant judgements and estimation uncertainty

Many areas of the financial statements involve management's judgements and assumptions as of the reporting date. Disclosures of significant judgements and areas of material estimation uncertainty should be focused, sufficiently detailed and up to date to reflect the current situation and any changes in underlying assumptions and sources of estimation uncertainty.

Careful consideration should be given to areas where management has made assumptions and taken judgements which are highly sensitive and have a material impact on amounts recognised and disclosed in the statements.

Valuation of investment property

The Code requires investment property to be measured at fair value, reflecting market conditions at the end of the reporting period. As with operational and surplus property valuations, investment property valuations are being impacted by current market uncertainty created by the Covid-19 pandemic. This has led RICs to instruct all of its member firms to consider including additional disclosure within valuation reports where valuations are therefore reported on the basis of 'material valuation uncertainty' as per VPS 3 and VPGA 10 of the RICS Red Book Global. Where this is the case valuers advise that less certainty and a higher degree of caution should be attached to valuations than would normally be the case.

Where such disclosure is included in management's experts' reports, and appropriate disclosure is correspondingly included within financial statements, auditors are likely to consider the inclusion of an 'emphasis of matter' paragraph within their audit report. An emphasis of matter paragraph is not a qualification or modification of the auditor's report and is used where a matter is appropriately presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial statements.

Management's experts' reports may also include additional caveats or limitations beyond the material uncertainty mentioned above. For example, the expert may not have been able to physically attend a property when forming their valuation. This limitation will be carefully considered by the auditor to determine whether the scope limitation stops the expert being able to produce an appropriate valuation. If appropriate valuations are unable to be produced auditors will need to consider whether modification of their audit reports is necessary.

Impairment

There are many areas of the financial statements which will need to be assessed for impairment considering the financial impact of the pandemic. At each reporting date, management must assess whether there is any indication that an asset may be impaired.

To put this into context for the local authority sector we have highlighted some key areas below where impairment assessments may be necessary in the current climate.

Non-current assets

Many authorities are currently going through a period of significant disruptions due to the lockdown as well as changes in the wider external economic and financial markets, which has resulted in significant changes to their operations, therefore undoubtedly authorities may be holding assets which become less utilised.

Further, it is important to note that where demand for an authority's services significantly decreases or ceases, this may be a trigger that the assets used to provide those services are impaired. Similarly, major social, demographic or environmental changes may have an impact on the number, nature or needs of an authority's service recipients and may therefore also provide an indicator of impairment.

Both IAS 36 and the Code require non-financial assets such as property plant and equipment (including PPE measured at historic cost at current value or at fair value, and whether owned, leased, financed via PFI or donated), intangible and heritage assets to be impaired if their carrying value exceeds their recoverable amount, with the recoverable amount being the higher of fair value less costs of disposal (FVLCOD) and value in use (VIU).

It is not always necessary to determine both an asset's FVLCOD and its VIU as, if either amount is equal to or exceeds the asset's carrying amount, then the asset is not impaired. The VIU of an asset held by a local authority is the present value of the asset's remaining service potential, or the present value of the future cash flows expected from cash generating assets.

It is important to note that most local authorities hold assets primarily to provide services rather than for generating cash flows. In such circumstances, it would be inappropriate to measure VIU by reference to the asset's cash flow and appropriate to instead measure it as the present value of the asset's service potential (VIU-SP).

The Code notes that impairment may also be due to physical damage, obsolescence breakage, a commitment to a significant reorganisation, or other factors. In the current climate the indicators of impairment are likely to be much wider and manifest in a number of ways through external and internal sources of information.

Furthermore, the reliability of valuations is affected by the volatility of the economic environment and various markets, including the property market. On-site valuations are harder to achieve with social distancing measures in place. For those assets under the revaluation model, there is a possibility that some valuations will be issued with 'material valuation uncertainty' declarations and authorities will need to ensure that disclosures regarding valuations are sufficient for readers of the accounts to understand key estimates or judgements involved in determining valuations at the year end.

This is an area of management judgement and detailed consideration will be required for each authority given its own set of facts and circumstances. Further detailed guidance is contained within Section 4.7 of the Code and IAS 36.

Financial instruments

Local authorities hold a variety of financial instruments including bank deposits, trade receivables, loans receivable and investments. Section 7.2.9 of the Code is concerned with impairment of financial instruments and is based upon the requirements of IFRS 9. This standard requires that forward-looking information (including macro-economic information) is considered, both when assessing whether there has been a significant increase in credit risk and when measuring expected credit losses. Authorities are required to recognise a loss allowance for expected credit losses on financial assets where the counterparty is not central government or a local authority for which statutory provisions prevent default.

Where credit risk on a financial asset has increased significantly since its initial recognition, as could be the case following the Covid-19 pandemic, authorities are required to measure the loss allowance at an amount equal to the lifetime expected credit loss. In making an assessment of whether credit risk has increased significantly it is necessary to consider the change in the risk of default occurring over the expected life of the financial asset, taking account of reasonable and supportable information available without undue cost or effort. Regardless of how this assessment is performed, there is a rebuttable presumption that the credit risk on a financial asset has increased significantly when contractual payments are more than 30 days past due, although it is not necessary to wait 30 days before determining that there has been significant increase in credit risk.

Authorities are required to measure expected credit losses on financial assets in a way that reflects unbiased, probability-weighted amounts determined by evaluating a range of possible outcomes, the time value of money and information available at the reporting date about past events, current conditions and forecasts of future economic conditions. Authorities need not identify every possible scenario but need to assess the possibility credit losses do or do not occur.

Investment in joint ventures/investment in subsidiaries

Some authorities have complex group structures and will need to consider whether the impact of Covid-19, including any measures taken to control it, are an indicator that the investments in joint ventures/subsidiaries are impaired. Authorities may also need to consider if there are any additional losses or contingencies in group entities for which they may become liable.

Employee benefits such as holiday pay accruals, sick pay and termination costs

Authorities will need to consider whether additional provisions and disclosures are necessary due to employee layoffs and other employee related items as a result of Covid-19.

Sick pay – Sick pay is likely to increase during this period and authorities should recognise a liability for sick pay in the period in which employees are off, even if it is not paid until a later period.

Termination costs – Under IAS 19 authorities should recognise a liability and expense for termination benefits at the earlier of when it can no longer withdraw the offer of those benefits and when it recognises costs for a restructuring that is within the scope of IAS 37 and involves the payment of termination benefits.

Any plans communicated after the reporting date should be treated as a non-adjusting post-balance sheet event in line with paragraph 3.8.2.13 of the Code.

Investments

Financial markets across the world have been very volatile due to the current uncertainty surrounding the economic impact of the pandemic. Where investments at measured at fair value, based on a quoted price in an active market for an identical asset (i.e. 'Level 1' in the fair value hierarchy) then, whilst such fair values might change materially within the next financial year, disclosure of the risk of material change is not required.

Where, however, investments (including financial assets and investment property) are measured using valuation techniques involving observable inputs other than quoted prices or unobservable inputs (i.e. at 'Level 2' or 'Level 3' of the fair value hierarchy as defined in section 2.10 of the Code and IFRS 13), and there is a significant risk of material adjustment to the carrying amount of the investment within the next financial year, then the estimation uncertainty disclosure requirements of 3.4.2.90 of the Code will apply.

The possibility of assets needing to be measured using unobservable inputs as a result of the pandemic should also be taken into account. Where measurement does move from 'Level 2' to 'Level 3' then authorities should note the additional disclosure requirements set out in section 2.10.4 of the Code.

Increased volatility and uncertainty will also have an impact on the valuation of defined benefit pension schemes as discussed below.

Pensions

Movements in the value of investments will affect the valuation of defined benefit pension schemes overall and in some cases, authorities may see a noticeable change in their defined benefit pension position. Some actuarial methodologies may also traditionally use forecast investment valuations to determine an estimate for the year end fund asset position. Given the volatility of the financial markets, the possibility of significant change in asset valuations as at the year-end should be considered and the fair value of plan assets updated where there has been a material movement compared to the forecast position. Using any estimated asset valuations increases the likelihood of a significant misstatement in the overall defined benefit pension scheme position at the year end.

Post balance sheet events

For 2019/20 financial statements, the existence of Covid-19 was recognised during the financial year and some of its impacts and actions taken by the Government were known by the reporting date of 31 March 2020, Covid-19 is an adjusting event and the effects of the pandemic must be taken into account in measuring assets and liabilities wherever relevant, based on facts and circumstances at year-end. However, new information about the likely severity and duration of the effects of Covid-19 will continue to emerge. Careful analysis and judgement, with reference to Section 3.8 of the Code and IAS 10, will be required to determine whether this information is 'adjusting' on the basis that it provides new evidence about the year-end situation, or is a non-adjusting event that should be disclosed.

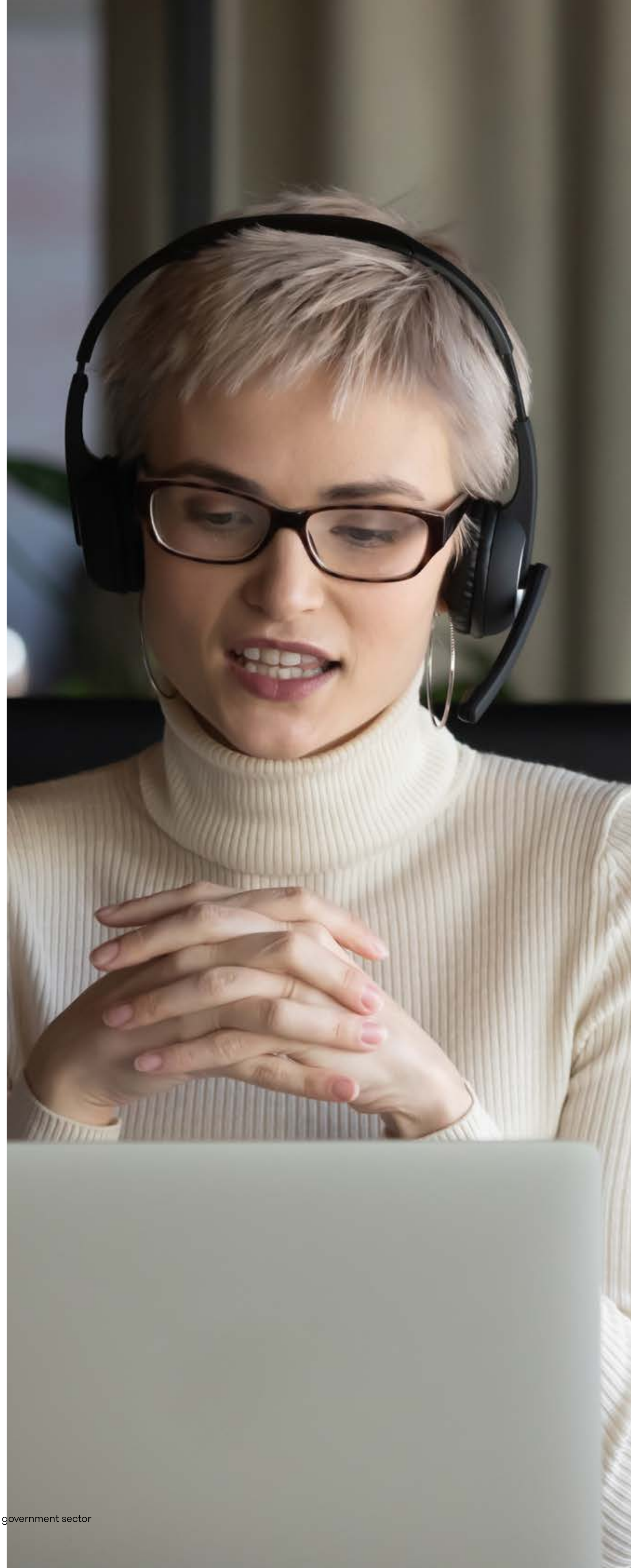
For those local authorities yet to conclude their financial statements for years prior to 2019/20, the emergence of new information about Covid-19 and its impact is a non-adjusting post balance sheet event requiring disclosure in those financial statements. The outbreak of the virus, its identification as Covid-19 by the WHO and actions subsequently taken by the Government do not provide additional evidence about the conditions that existed at the reporting date. Therefore, for 2018/19 (or earlier) financial statements the emergence of Covid-19 and its impact is a non-adjusting event. In line with section 3.8.3.2 of the Code, disclosure is still required for non-adjusting events regarding the nature of the event and estimate of the financial effect if possible.

We would encourage all authorities to consider all these points when preparing their financial statements.

Deferral of IFRS 16 Leases

At its meeting on 27 March CIPFA/LASAAC agreed to defer the implementation of IFRS 16 Leases to the 2021/22 financial year, with an effective date of 1 April 2021. This decision aligns with the proposals across the public sector.

Although the implementation of IFRS 16 has been delayed to 1 April 2021, in our view authorities still need to include disclosure in their 2019/20 statements to comply with the requirement at 3.3.4.3 of the Code and the underlying requirement of IAS 8 paragraphs 30 and 31. As a minimum, we would expect authorities to disclose the title of the standard, the date of initial application and the nature of the changes in accounting policy for leases. If the impact of IFRS 16 is not known or reasonably estimable, we would expect the financial statements to state this.



Other sector issues and practicalities to consider

Cyber security

Sadly more instances of cyber-crime are occurring as fraudsters are taking advantage of an increase in on-line activity, and in some cases a weakening of controls. The most common types of cyber-crime currently are:

- **Procurement fraud** – companies claiming to sell personal protective equipment and then not delivering the goods
- **Phishing emails** – with links leading to fake website which can cause viruses or steal personal details or passwords
- **Mandate/CEO fraud** – these involve official looking emails requesting changes to bank details for either suppliers/employees; and
- **Unsolicited goods/services/financial support** – these goods are never delivered and often require advanced fee payment.

As the majority of staff will be working on-line it is of utmost importance that local authorities make all employees aware of the type of cyber-crimes that are prevalent, to be particularly vigilant, and to maintain strong internal controls.

Impact on audit work/ external scrutiny process

- **Audit approach** – Planned audit approaches are likely to change due to logistical issues as well as a heightened risk in several areas of the financial statements, resulting in additional testing being required. Social distancing will have a significant impact on how auditors obtain the evidence they require as well as how they communicate. You will see an increase in use of technology as may see more substantive testing, particularly if the operation of internal controls has been affected. Auditors and local authorities will need to work together to identify what alternative measures are possible in the current environment without reducing the quality of audit evidence.

  The amount of audit work and length of audits are therefore likely to increase due to the impact on financial reporting and additional scrutiny over key estimates and significant judgments made by management should be anticipated.

- **Audit reports** – Due to the uncertainties arising from the pandemic there is a greater likelihood of audit reports containing emphasis of matter paragraphs and potentially being modified or qualified. Where the auditor anticipates a potential modification they will communicate the circumstances to officers and those charged with governance.

- **Audit Committee and other significant meetings** – Audit Committee meetings may be impacted if physical meetings are still prohibited or advised against at the time of concluding audits. Audit committees will need to discuss with their auditors how best to communicate, holding virtual meetings where possible. Annual and other significant meetings may also have to be held virtually, postponed or cancelled.

- **Accounts preparation and audit timetable** – MHCLG laid the Accounts and Audit Regulations (Coronavirus) (Amendment) Regulations 2020 before Parliament in April 2020. The effect of the Regulations is to extend the timetable for local authorities to prepare their draft 2019/20 statement of accounts to 31 August 2020, with the period for the exercise of public rights to commence on or before 1 September 2020. The Regulations also extend the deadline for the publication of statements of accounts, together with any certificate or opinion of the local auditor, to 30 November 2020. Local auditors will already have liaised with local authorities over the anticipated timetable for the preparation and audit of the 2019/20 financial statements.

- **Inspection of documents** – Section 26 of the Local Audit and Accountability Act 2014 gives any interested person the right to inspect the accounting records for the financial year and all books, deeds, contracts, bills, vouchers, receipts and other documents relating to those records. The Accounts and Audit Regulations 2015 prescribe that these rights may only be exercised in a single 30 working day period, with the responsible financial officer required to advise the relevant period via publication of a statement including publication on the authority's website. In light of the pandemic and with social distancing measures in place, authorities will need to consider how they will allow the public the opportunity to exercise their rights in relation to the accounts. Authorities must publish the dates of their public inspection period, and given the removal of the common inspection period and extension of the overall deadlines for this year, authorities may wish to include public notice on their websites when the public inspection period would usually commence, explaining why they are departing from normal practice for 2019/20 accounts.

  The National Audit Office is currently reviewing its publication 'Local authority accounts – a guide to your rights' and updates will be made to take account of the changes announced in the Accounts and Audit (Coronavirus) (Amendment) Regulations 2020.

Engagement with experts

In uncertain times, it is particularly important to maintain regular dialogue with management experts where they have roles in relation to the preparation of accounts. Some examples include:

- **Valuation experts** – These should be contacted as soon as possible to establish how they will apply the most accurate valuation method, in light of the current uncertainty and with social distancing measures in place. RICS have issued some advice[1] to its members on that matter, including highlighting the possibility that some valuations may need to be issued with 'material valuation uncertainty' declarations.
- **Actuaries** – Discussions with actuaries, engaged to support with defined benefit pension schemes, should be held regarding updates to the assumptions used and timing of their report, in order to obtain the most accurate valuation possible.

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

Further resources and guidance

The amount of information and constant updates can be overwhelming and therefore we have included some key websites for guidance on both the operational and financial aspects that are being updated regularly so that you have these to hand.

Grant Thornton Covid-19 Hub

Grant Thornton have a dedicated Covid-19 hub[2], which covers a number of topics including: navigating government support, cyber security, contingency planning, impact on businesses and option to join weekly webinars which provide practical steps to dealing with the impact of the pandemic.

CIPFA

CIPFA have issued guidance[3] on the financial reporting implications of Covid-19 covering some key areas including the impact on the narrative report, events after the reporting period and impact on Property Plant and Equipment, Investment Property and Financial Instruments.

National Audit Office

The National Audit Office will publish an updated guide[4] to public rights in relation to the accounts, taking into account the impact of the pandemic.

Financial Reporting Council

The Financial Reporting Council (FRC) are continuously updating their advice on the impact of the pandemic on financial reporting and audits.[5] This is relevant for both authorities and auditors.

Local Government Association

The Local Government Association has published guidance and resources relating to Covid-19 on its website.[6]

Ministry of Housing Communities and Local Government

The Ministry of Housing Communities and Local Government (MHCLG) has published extensive Covid-19 related guidance for the local government sector.[7]

Please note that this is a constantly evolving situation and therefore information included within this report may change over time.

Contact us

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2 https://www.grantthornton.co.uk/en/insights/responding-to-coronavirus-covid-19/
3 https://www.cipfa.org/policy-and-guidance/cipfa-bulletins/cipfa-bulletin-05-closure-of-the-201920-financial-statements
4 https://www.nao.org.uk/code-audit-practice/council-accounts-a-guide-to-your-rights/
5 https://www.frc.org.uk/about-the-frc/covid-19/
6 https://www.local.gov.uk/our-support/coronavirus-information-councils
7 https://www.gov.uk/guidance/coronavirus-covid-19-guidance-for-local-government

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