

The Audit Findings for South Hams District Council

Year ended 31 March 2022

November 2022



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This Audit Findings presents the observations arising from the audit that are significant to the responsibility of those charged with governance to oversee the financial reporting process, as required by International Standard on Auditing (UK) 260. Its contents will be discussed with management and the Audit and Governance Committee.

Jackson Murray

Name : Jackson Murray

For Grant Thornton UK LLP

Date: November 2022

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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1. Headlines

This table summarises the key findings and other matters arising from the statutory audit of South Hams District Council ('the Council') and the preparation of the Council's financial statements for the year ended 31 March 2022 for those charged with governance.

Financial Statements

Under International Standards of Audit (UK) (ISAs) and the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report whether, in our opinion:

- the Council's financial statements give a true and fair view of the financial position of the Council and its income and expenditure for the year; and
- have been properly prepared in accordance with the CIPFA/LASAAC code of practice on local authority accounting and prepared in accordance with the Local Audit and Accountability Act 2014.

We are also required to report whether other information published together with the audited financial statements (including the Annual Governance Statement (AGS) and Narrative Report), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

Our audit work was completed in a hybrid manner, with a mixture of on-site and remote during July-November. Our findings are summarised on pages 7 to 15. We have identified non-trivial adjustments to the draft financial statements that were provided to audit, which have been adjusted in the final version of the financial statements. These are detailed in Appendix C. We have also raised recommendations for management as a result of our audit work in Appendix A. Our follow up of recommendations from the prior year's audit are detailed in Appendix B.

Our work is substantially complete and there are no matters of which we are aware that would require modification of our audit opinion subject to the following outstanding matters;

- final testing of the Movement In Reserves Statement and the Expenditure and Funding Analysis;
- concluding procedures performed on the valuation of land and buildings with management co-operation;
- receipt of assurances from the Devon Pension Fund auditor; and
- satisfactory completion of final quality reviews and any resultant queries.

A national accounting issue has been identified for Local Government bodies who have significant infrastructure asset balances, which is the case for South Hams District Council. The Government and CIPFA have consulted on a proposed statutory override for some aspects of this issue. This statutory override will not be laid before Parliament in time to allow it to come into effect prior to 30 November 2022, which is the date in legislation for audited 2021/22 financial statements. For this reason, we will not be able to issue our audit opinion until after the statutory override is enacted. We anticipate that our audit opinion will therefore be issued in early 2023, subject to the final content of the proposed statutory override.

Following the satisfactory completion of all of the above, we will then be in a position to conclude the audit and issue our audit opinion following our:

- receipt of the signed management representation letter; and
- receipt and review of the final set of financial statements.

We have concluded that the other information to be published with the financial statements is consistent with our knowledge of your organisation and the financial statements we have audited.

Our anticipated audit report opinion at the date of drafting this report will be unmodified.

1. Headlines

Value for Money (VFM) arrangements

Under the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to consider whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. Auditors are now required to report in more detail on the Council's overall arrangements, as well as key recommendations on any significant weaknesses in arrangements identified during the audit.

Auditors are required to report their commentary on the Council's arrangements under the following specified criteria:

- improving economy, efficiency and effectiveness;
- financial sustainability; and
- governance.

We have not yet completed all of our VFM work and so are not in a position to issue our Auditor's Annual Report. An audit letter explaining the reasons for the delay was issued to the Chair of the Audit and Governance Committee in September 2022. We currently expect to issue our Auditor's Annual Report in February 2023. This is in line with the National Audit Office's revised deadline, which requires the Auditor's Annual Report to be issued no more than three months after the date of the opinion on the financial statements.

As part of our work, we considered whether there were any risks of significant weakness in the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources. We have not identified any risks of significant weakness. Our work on VFM is underway and an update is set out in the value for money arrangements section of this report.

Statutory duties

The Local Audit and Accountability Act 2014 ('the Act') also requires us to:

- report to you if we have applied any of the additional powers and duties ascribed to us under the Act; and
- to certify the closure of the audit.

We have not exercised any of our additional statutory powers or duties.

We expect to certify the completion of the audit upon the completion of our work on the Council's VFM arrangements, which will be reported in our Auditor's Annual Report in February 2023.

Significant Matters

We did not encounter any significant difficulties during our work.

2. Financial Statements

Overview of the scope of our audit

This Audit Findings Report presents the observations arising from the audit that are significant to the responsibility of those charged with governance to oversee the financial reporting process, as required by International Standard on Auditing (UK) 260 and the Code of Audit Practice ('the Code'). Its contents have been discussed with management.

As auditor we are responsible for performing the audit, in accordance with International Standards on Auditing (UK) and the Code, which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

Audit approach

Our audit approach was based on a thorough understanding of the Council's business and is risk based, and in particular included:

- an evaluation of the Council's internal controls environment, including its IT systems and controls; and
- substantive testing on significant transactions and material account balances, including the procedures outlined in this report in relation to the key audit risks.

We did not significantly alter our audit approach to that reported in our Audit Plan.

Conclusion

We have substantially completed our audit of your financial statements and subject to outstanding queries being resolved, and conclusion of the national infrastructure accounting issue, we anticipate issuing an unqualified audit opinion. Outstanding items are included on page 3.

We have identified a number of adjustments to the draft financial statements as reported in appendix C.

Acknowledgements

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team and other staff.

For the first time since the start of the COVID-19 Pandemic, we completed some of our audit testing on site meeting with officers face to face as well as working remotely.

As in previous years, significant time has been invested in the audit by Council and audit staff and a good professional working relationship has been maintained.

2. Financial Statements



Our approach to materiality

The concept of 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.

Materiality levels remain the same as reported in our audit plan on 29 June 2022.

We detail in the table opposite our determination of materiality for South Hams District Council.

Council Amount Qualitative factors considered

| | | |
|---|---------|---|
| Materiality for the financial statements | £1,060k | We considered materiality from the perspective of the users of the financial statements. The Council prepares an expenditure based budget for the financial year and monitors spend against this, therefore gross expenditure was deemed as the most appropriate benchmark. This benchmark was used in the prior year. We deemed that 2% was an appropriate rate to apply to the expenditure benchmark. |
| Performance materiality | £795k | The Council does not have a history of significant deficiencies so 75% is considered a reasonable percentage for performance materiality. |
| Trivial matters | £53k | Calculated as a percentage of headline materiality and in accordance with auditing standards. |
| Materiality for senior officer remuneration | £20k | Based on the public sensitivity surrounding the disclosure of senior officer pay. |



2. Financial Statements - Significant risks

Significant risks are defined by ISAs (UK) as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement.

This section provides commentary on the significant audit risks communicated in the Audit Plan.

Risks identified in our Audit Plan

Commentary

Management override of controls

Under ISA (UK) 240 there is a non rebuttable presumed risk that the risk of management override of controls is present in all entities. The Council faces external scrutiny of its spending and this could potentially place management under undue pressure in terms of how they report performance.

In the 2020/21 audit, we identified that there was significant manual intervention required from the finance team to reconcile the transaction reports to the financial statements which are indicative of the conditions which create this risk. This was due to the ability of the team to run IT reports from the finance ledger which are large in size due to the number of financial transactions.

We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk, which was one of the most significant assessed risks of material misstatement.

We have:

- evaluated the design effectiveness of management controls over journals;
- analysed the journals listing and determined the criteria for selecting high risk unusual journals;
- identified and tested unusual journals made during the year and the accounts production stage for appropriateness and corroboration; and
- gained an understanding of the accounting estimates and critical judgements applied by management and considered their reasonableness.

Our sample testing of journal entries posted in the year did not identify any indication of management override of controls.

We did not identify any significant changes in estimation techniques adopted between years (more information on our work on the Council's key estimates can be found on pages 11 to 14).

We are pleased to note that the transaction report issues we reported in 2020/21 have been resolved.

During our work, we identified control weaknesses relating to journal system user rights which we have detailed in the internal controls findings in Appendix A. In response to those findings, we increased the risk associated which doubled our planned substantive testing sample. As above, we found no errors or evidence of override.



2. Financial Statements - Significant risks

| Risks identified in our Audit Plan | Commentary |
|--|--|
| <p>The revenue cycle includes fraudulent revenue transactions (ISA240)</p> | <p>No changes were made to our assessment reported in the audit plan, and this risk was rebutted as per justification below:</p> <p>Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue.</p> <p>This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.</p> <p>Having considered the risk factors set out in ISA240 and the nature of the Council revenue streams, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because:</p> <ul style="list-style-type: none"> • there is little incentive to manipulate revenue recognition; • opportunities to manipulate revenue recognition are very limited; and • the culture and ethical frameworks of local authorities, including that of South Hams District Council, mean that all forms of fraud are seen as unacceptable. |
| <p>Risk of fraud related to expenditure recognition (PAF Practice Note 10)</p> | <p>No changes to our assessment reported in the audit plan, this risk was rebutted as per justification below:</p> <p>The risk of material fraud arising from expenditure recognition can be rebutted because, per Practice note 10, misstatements may arise where the audited body is under pressure to meet externally set targets. This environment does not exist at the Council.</p> |
| <p>Valuation of Investment Property</p> <p>The Council has investment properties which must be valued annually at 31st March. At 31 March 2022 the portfolio was worth £19m.</p> <p>As with other land and buildings, the valuation for these properties is sensitive to changes in key assumptions. We will consider the key assumptions used in the valuation;</p> <ul style="list-style-type: none"> • Rental yield; and • Annual income. <p>Due to the estimation and judgements involved, we consider this to be a significant risk.</p> | <p>We have:</p> <ul style="list-style-type: none"> • evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work; • evaluated the competence, capabilities and objectivity of the valuation expert; • written to the valuer to confirm the basis on which the valuation was carried out; • challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding, the Council's valuer's report and the assumptions that underpin the valuation. This included testing to rental or lease contracts to check the annual income for properties; and • tested revaluations made during the year to see if they had been input correctly into the Council's asset register. <p>Our audit work has not identified any issues in respect of the valuation of Investment Property.</p> |

2. Financial Statements - Significant risks

Risks identified in our Audit Plan

Commentary

Valuation of land and buildings

The Council revalues its land and buildings on a rolling five yearly basis. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved and the sensitivity of this estimate to changes in key assumptions.

Additionally, management will need to ensure the carrying value in the Council financial statements is not materially different from the current value or the fair value (for surplus assets) at the financial statements date, where a rolling programme is used.

We therefore identified valuation of land and buildings, particularly revaluations and impairments, as a significant risk.

We have:

- evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work;
- evaluated the competence, capabilities and objectivity of the valuation expert;
- written to the valuer to confirm the basis on which the valuation was carried out;
- challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding, the Council's valuer's report and the assumptions that underpin the valuation;
- tested revaluations made during the year to see if they had been input correctly into the Council's asset register; and
- evaluated the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value at year end.

Our key findings from this testing are:

- corroborating evidence for the gross internal area data used in the valuation calculations for 5 of our 24 properties sampled is to be taken from external sources but internal records from measured surveys was not available. Further detail is available on p11 and appendix A.

2. Financial Statements - Significant risks

Risks identified in our Audit Plan

Commentary

Valuation of 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 pension fund net liability is considered a significant estimate due to the size of the numbers involved (£53m in the Council's balance sheet) and the sensitivity of the estimate to changes in key assumptions.

The methods applied in the calculation of the IAS 19 estimates are routine and commonly applied by all actuarial firms in line with the requirements set out in the Code of practice for local government accounting (the applicable financial reporting framework). We have therefore concluded that there is not a significant risk of material misstatement in the IAS 19 estimate due to the methods and models used in their calculation.

The source data used by the actuaries to produce the IAS 19 estimates is provided by administering authorities and employers. We do not consider this to be a significant risk as this is easily verifiable.

The actuarial assumptions used are the responsibility of the entity but should be set on the advice given by the actuary. A small change in the key assumptions (discount rate, inflation rate, salary increase and life expectancy) can have a significant impact on the estimated IAS 19 liability. In particular the discount and inflation rates, where our consulting actuary has indicated that a 0.1% change in these two assumptions would have approximately 3% effect on the liability. We have therefore concluded that there is a significant risk of material misstatement in the IAS 19 estimate due to the assumptions used in their calculation. With regard to these assumptions we have therefore identified valuation of the Council's pension fund net liability as a significant risk.

During the course of our audit procedures we have:

- identified the controls put in place by management to ensure that the pension fund liability is not materially misstated, and assessment of whether these controls were implemented as expected and whether they are sufficient to mitigate the risk of material misstatement;
- reviewed the competence, expertise and objectivity of the actuary who carried out the pension fund valuation, and gain an understanding of the basis on which the valuation is carried out;
- reviewed of the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial report from the actuary; and
- undertaken procedures to confirm the reasonableness of actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performed any additional procedures suggested by their report.

Planned procedures under our audit approach which at the date of writing remain in progress include:

- procedures upon receipt of assurance responses from the Devon Pension Fund auditor.

At the date of writing, there are no other issues arising from our work in respect of this risk which require reporting to the Audit and Governance Committee as those charged with governance. We will update this position to the date of issuing our auditor's report.

2. Financial Statements – key judgements and estimates

This section provides commentary on key estimates and judgements inline with the enhanced requirements for auditors.

| Significant judgement or estimate | Summary of management's approach | Audit Comments | Assessment |
|---------------------------------------|---|---|--|
| Land and Building valuations – £66.9m | <p>Other land and buildings comprises £22.2m of specialised assets such as leisure centres and bus stations, which are required to be valued at depreciated replacement cost (DRC) at year end, reflecting the cost of a modern equivalent asset necessary to deliver the same service provision. The remainder of other land and buildings (£44.7m) are not specialised in nature and are required to be valued at existing use in value (EUV) at year end. The Council has engaged its internal valuation experts to complete the valuation of properties as at 31 March 2022 in line with their five yearly cyclical basis. 25% of total assets were revalued during 2021/22.</p> <p>Management place reliance on the work of the valuation experts and review and challenge the work of the valuer when it is reported back to them. The valuation experts are independent from the finance team which ensures that they maintain objectivity when undertaking their valuations.</p> <p>The total year end valuation of land and buildings was £66.9m, a net £0.3m change from 2020/21 (£66.6m) when valuation and other movements were taken into account, such as capital additions and depreciation.</p> | <p>We assessed management's expert and found them to be competent, capable and objective.</p> <p>We corroborated the completeness and accuracy of underlying data used in the valuations, such as lease contracts, to source data.</p> <p>We challenged and corroborated key assumptions adopted within a sample of valuations, considering their relevance when compared to alternatives, including those used by close neighbours.</p> <p>We have not identified any significant changes in valuation method in year, nor have we identified any significant incorrect assumptions in respect of alternative site assumptions for DRC valuations.</p> <p>As part of our testing methodology we formed an expectation of value of assets not formally revalued in year using information provided to auditors by Gerald Eve. This allowed us to project the valuation of those assets to the Balance Sheet date (31 March 2022). We were satisfied that no material difference arose between our expected value and the carrying value recorded in the financial statements.</p> <p>As at reporting date we are still concluding the work on land and buildings valuations.</p> <p>Of 24 assets that were sampled, for 5 of them, gross internal area workings from floor plans are to be corroborated to external data from the Valuation Office Agency but not from internal measured surveys. Data used in calculations was from brought forward schedules that the valuer had access to but the internal records had not been kept. A finding has been raised in appendix A.</p> | <p>A finding has been raised in respect of the work completed</p> <p>We consider management's process is appropriate and key assumptions are neither optimistic or cautious.</p> |

2. Financial Statements - key judgements and estimates

| Significant judgement or estimate | Summary of management's approach | Audit Comments | Assessment |
|--|--|--|--|
| Investment Property Valuation - £18.6m | <p>Investment Properties comprise £18.6m of assets held to generate rental income such as office blocks, which are required to be valued at Fair Value (FV) at year end, reflecting the market value, i.e. the price that would be received to sell the asset.</p> <p>The Council has engaged an external valuer to complete the valuation of properties as at 31 March 2022.</p> <p>The valuation changes in fair value were (£0.05)m in 2021/22.</p> | <p>We assessed management's expert and found them to be competent, capable and objective.</p> <p>The revaluation methodology and assumptions are considered reasonable. There are no indicators of material misstatement.</p> <p>From our review of the source data provided to the valuer and challenge of the assumptions adopted we did not identify any issues regarding the rental agreements and inputs into the valuation.</p> <p>No issues were identified following this work and our follow up queries to management's expert.</p> | <p>We consider management's process is appropriate and key assumptions are neither optimistic or cautious.</p> |

2. Financial Statements - key judgements and estimates

| Significant judgement or estimate | Summary of management's approach | Audit Comments | Assessment | | | | | | | | | | | | | | | | | | | | | | | | |
|--|--|--|------------|---------------|-----------|------------|---------------|-------|-------------|---|-----------------------|-------|---------------|---|---------------|-------|---------------|---|--|-------------|-----------------------|---|--|-------------|-----------------------|---|---|
| Net pension liability – £52.6m | <p>The Council's net pension liability at 31 March 2022 is £52.6m (PY £61.3m) comprising the Devon Pension Fund Local Government and unfunded defined benefit pension scheme obligations. The Council uses Barnett Waddingham to provide actuarial valuations of the Council's assets and liabilities derived from these schemes. A full actuarial valuation is required every three years.</p> <p>The latest full actuarial valuation was completed in 31 March 2019. Given the significant value of the net pension fund liability, small changes in assumptions can result in significant valuation movements. There has been a £12.6m net actuarial gain during 2021/22.</p> | <p>With the use of the consulting actuary as an auditor's expert, we have confirmed that management's actuary are competent, capable and objective.</p> <p>We considered that the significant risk in respect of pension fund valuation related to the assumptions used in the calculation, rather than the methodology used with is standard and in accordance with the requirements of the CIPFA Code and accounting standards. We make use of the consulting actuary (PwC) to assess the reasonableness of the assumptions adopted and set out below our consideration of these assumptions.</p> <table border="1"> <thead> <tr> <th>Assumption</th> <th>Actuary Value</th> <th>PwC range</th> <th>Assessment</th> </tr> </thead> <tbody> <tr> <td>Discount rate</td> <td>2.60%</td> <td>2.55%-2.60%</td> <td>●</td> </tr> <tr> <td>Pension increase rate</td> <td>3.20%</td> <td>3.05% - 3.45%</td> <td>●</td> </tr> <tr> <td>Salary growth</td> <td>4.20%</td> <td>3.70% - 5.20%</td> <td>●</td> </tr> <tr> <td>Life expectancy – Males currently aged 45 / 65</td> <td>23.2 / 21.8</td> <td>21.9-24.4 / 20.5-23.1</td> <td>●</td> </tr> <tr> <td>Life expectancy – Females currently aged 45 / 65</td> <td>25.2 / 24.2</td> <td>24.9-26.4 / 23.4-25.0</td> <td>●</td> </tr> </tbody> </table> <p>Our work includes procedures to ensure the completeness and accuracy of the underlying information used to determine the estimate. We review the data provided by the Council and the Pension Fund and corroborate this to supporting payroll data used elsewhere in our audit procedures. We also obtain assurances from the auditor of the Devon Pension Fund over the processes and controls in place, and we currently awaiting these assurances.</p> <p>Through our procedures to date, we are satisfied that the estimate is reasonable and that the disclosures within the financial statements are adequate. We await receipt of assurances from the Devon Pension Fund auditor to allow us to conclude our work.</p> | Assumption | Actuary Value | PwC range | Assessment | Discount rate | 2.60% | 2.55%-2.60% | ● | Pension increase rate | 3.20% | 3.05% - 3.45% | ● | Salary growth | 4.20% | 3.70% - 5.20% | ● | Life expectancy – Males currently aged 45 / 65 | 23.2 / 21.8 | 21.9-24.4 / 20.5-23.1 | ● | Life expectancy – Females currently aged 45 / 65 | 25.2 / 24.2 | 24.9-26.4 / 23.4-25.0 | ● | <p>We consider management's process is appropriate and key assumptions are neither optimistic or cautious, subject to receipt of pension fund auditor assurances.</p> |
| Assumption | Actuary Value | PwC range | Assessment | | | | | | | | | | | | | | | | | | | | | | | | |
| Discount rate | 2.60% | 2.55%-2.60% | ● | | | | | | | | | | | | | | | | | | | | | | | | |
| Pension increase rate | 3.20% | 3.05% - 3.45% | ● | | | | | | | | | | | | | | | | | | | | | | | | |
| Salary growth | 4.20% | 3.70% - 5.20% | ● | | | | | | | | | | | | | | | | | | | | | | | | |
| Life expectancy – Males currently aged 45 / 65 | 23.2 / 21.8 | 21.9-24.4 / 20.5-23.1 | ● | | | | | | | | | | | | | | | | | | | | | | | | |
| Life expectancy – Females currently aged 45 / 65 | 25.2 / 24.2 | 24.9-26.4 / 23.4-25.0 | ● | | | | | | | | | | | | | | | | | | | | | | | | |

2. Financial Statements - key judgements and estimates

| Significant judgement or estimate | Summary of management's approach | Audit Comments | Assessment |
|-----------------------------------|---|--|---|
| Minimum Revenue Provision - £0.5m | <p>The Council is responsible on an annual basis for determining the amount charged for the repayment of debt known as its Minimum Revenue Provision (MRP). The basis for the charge is set out in regulations and statutory guidance.</p> <p>The Council calculates the MRP charge in accordance with the stated policy in the Treasury Management Strategy approved by members prior to the beginning of the financial year, using the asset life method as is allowed under the regulations.</p> | <p>We assessed that the Council's policy on MRP complies with the Statutory guidance and noted no changes in policy from last year.</p> <p>In considering the MRP charge, we benchmarked the Council's MRP charge as a percentage of its Capital Financing Requirement. The 2021/22 MRP charge is considered appropriate as it was above 2% of the CFR at 2.41%.</p> <p>Government have consulted on changes to the regulations that underpin MRP, to clarify that capital receipts may not be used in place of a prudent MRP and that MRP should be applied to all unfinanced capital expenditure and that certain assets should not be omitted. The consultation highlighted that the intention is not to change policy, but to clearly set out in legislation, the practices that authorities should already be following. Government will issue a full response to the consultation in due course.</p> | <p>We consider management's process is appropriate and key assumptions are neither optimistic or cautious</p> |

2. Financial Statements - matters discussed with management

This section provides commentary on the significant matters we discussed with management during the course of the audit.

| Significant matter | Commentary | Auditor view and management response |
|--|--|--|
| <p>Infrastructure Assets Following recent regulatory reviews and discussion between firms at a national level, it appears that some local authorities may be accounting for Infrastructure assets incorrectly. There are a number of aspects to this, but in particular capital spend on replacing components has been added without derecognition of the previous component and hence has potentially materially enhanced the value of infrastructure assets in error.</p> | <p>During the audit fieldwork, CIPFA have been working on a mechanism for updating the disclosure of infrastructure assets.</p> <p>The audit team have obtained evidence for the gross book value of assets and challenged management on the useful economic lives assumptions used for the calculation of depreciation.</p> <p>The draft financial statements included a depreciation charge of £457k for infrastructure assets in 2021/22, compared to a charge of £439k in 2020/21. We confirmed that this had been calculated using the adopted useful lives of between 15 to 50 years depending on the type of asset.</p> | <p>The audit team await the outcome of the CIPFA wide statutory override before we can complete the audit. This will not be possible until 2023 given the current planned Government timetable.</p> <p>The audit team will wait until the Override is in force before considering whether any recommendations are needed in this area</p> <p>Management response We await the final audit conclusion on this matter</p> |

2. Financial Statements - other communication requirements

We set out below details of other matters which we, as auditors, are required by auditing standards and the Code to communicate to those charged with governance.

| Issue | Commentary |
|---|--|
| Matters in relation to fraud | We have previously discussed the risk of fraud with the Audit and Governance Committee. We have not been made aware of any other incidents in the period and no other issues have been identified during the course of our audit procedures. |
| Matters in relation to related parties | We are not aware of any related parties or related party transactions which have not been disclosed. |
| Matters in relation to laws and regulations | You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any incidences from our audit work. |
| Written representations | A standard letter of representation has been requested from the Council which is included in the Audit and Governance Committee papers. |
| Confirmation requests from third parties | We requested from management permission to send confirmation requests to the Council's bank and institutions the Council had year end investments and borrowings with. This permission was granted, the requests were sent and returned with positive confirmations. |
| Accounting practices | We have evaluated the appropriateness of the Council's accounting policies, accounting estimates and financial statement disclosures. On review, we requested that management included a policy for prior period adjustments. |
| Audit evidence and explanations/ significant difficulties | All information and explanations requested from management was provided. |

2. Financial Statements - other communication requirements



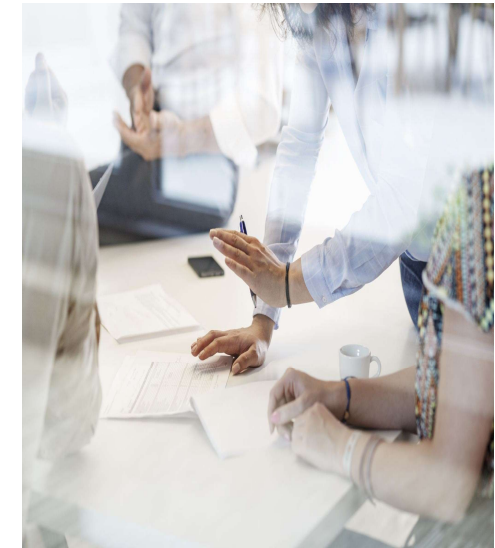
Our responsibility

As auditors, we are required to “obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern” (ISA (UK) 570).

| Issue | Commentary |
|---------------|--|
| Going concern | <p>In performing our work on going concern, we have had reference to Statement of Recommended Practice – Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom (Revised 2020). The Financial Reporting Council recognises that for particular sectors, it may be necessary to clarify how auditing standards are applied to an entity in a manner that is relevant and provides useful information to the users of financial statements in that sector. Practice Note 10 provides that clarification for audits of public sector bodies.</p> <p>Practice Note 10 sets out the following key principles for the consideration of going concern for public sector entities:</p> <ul style="list-style-type: none"> the use of the going concern basis of accounting is not a matter of significant focus of the auditor's time and resources because the applicable financial reporting frameworks envisage that the going concern basis for accounting will apply where the entity's services will continue to be delivered by the public sector. In such cases, a material uncertainty related to going concern is unlikely to exist, and so a straightforward and standardised approach for the consideration of going concern will often be appropriate for public sector entities for many public sector entities, the financial sustainability of the reporting entity and the services it provides is more likely to be of significant public interest than the application of the going concern basis of accounting. Our consideration of the Council's financial sustainability is addressed by our value for money work, which is covered elsewhere in this report. <p>Practice Note 10 states that if the financial reporting framework provides for the adoption of the going concern basis of accounting on the basis of the anticipated continuation of the provision of a service in the future, the auditor applies the continued provision of service approach set out in Practice Note 10. The financial reporting framework adopted by the Council meets this criteria, and so we have applied the continued provision of service approach. In doing so, we have considered and evaluated:</p> <ul style="list-style-type: none"> the nature of the Council and the environment in which it operates; the Council's financial reporting framework; the Council's system of internal control for identifying events or conditions relevant to going concern; and management's going concern assessment. <p>On the basis of this work, we have obtained sufficient appropriate audit evidence to enable us to conclude that:</p> <ul style="list-style-type: none"> a material uncertainty related to going concern has not been identified; and management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate. |

2. Financial Statements - other responsibilities under the Code

| Issue | Commentary |
|---|---|
| Other information | <p>We are required to give an opinion on whether the other information published together with the audited financial statements (including the Annual Governance Statement and Narrative Report), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.</p> <p>No inconsistencies have been identified. We plan to issue an unmodified opinion in this respect</p> |
| Matters on which we report by exception | <p>We are required to report on a number of matters by exception in a number of areas:</p> <ul style="list-style-type: none"> • if the Annual Governance Statement does not comply with disclosure requirements set out in CIPFA/SOLACE guidance or is misleading or inconsistent with the information of which we are aware from our audit; • if we have applied any of our statutory powers or duties; and • where we are not satisfied in respect of arrangements to secure value for money and have reported [a] significant weakness/es. <p>We have nothing to report on these matters.</p> |
| Specified procedures for Whole of Government Accounts | <p>We are required to carry out specified procedures (on behalf of the NAO) on the Whole of Government Accounts (WGA) consolidation pack under WGA group audit instructions.</p> <p>Note that has not yet begun as the WGA group audit instructions for 2021/22 has yet to be issued. As such we will be unable to issue our audit certificate alongside the audit opinion.</p> |
| Certification of the closure of the audit | <p>We intend to delay the certification of the closure of the 2021/22 audit of South Hams District Council in the audit report due to incomplete VFM and WGA work.</p> |



3. Value for Money arrangements

Approach to Value for Money work for 2021/22

The National Audit Office issued its guidance for auditors in April 2020. The Code requires auditors to consider whether the body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

When reporting on these arrangements, the Code requires auditors to structure their commentary on arrangements under the three specified reporting criteria.



Improving economy, efficiency and effectiveness

Arrangements for improving the way the body delivers its services. This includes arrangements for understanding costs and delivering efficiencies and improving outcomes for service users.



Financial Sustainability

Arrangements for ensuring the body can continue to deliver services. This includes planning resources to ensure adequate finances and maintain sustainable levels of spending over the medium term (3-5 years)



Governance

Arrangements for ensuring that the body makes appropriate decisions in the right way. This includes arrangements for budget setting and management, risk management, and ensuring the body makes decisions based on appropriate information

Potential types of recommendations

A range of different recommendations could be made following the completion of work on the body's arrangements to secure economy, efficiency and effectiveness in its use of resources, which are as follows:



Statutory recommendation

Written recommendations to the body under Section 24 (Schedule 7) of the Local Audit and Accountability Act 2014. A recommendation under schedule 7 requires the body to discuss and respond publicly to the report.



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

3. VFM - our procedures and conclusions

We have not yet completed all of our VFM work and so are not in a position to issue our Auditor's Annual Report. An audit letter explaining the reasons for the delay was provided to the Chair of the Audit and Governance Committee in September 2022. We expect to issue our Auditor's Annual Report in February 2023. This is in line with the National Audit Office's revised deadline, which requires the Auditor's Annual Report to be issued no more than three months after the date of the opinion on the financial statements.

As part of our work, we considered whether there were any risks of significant weakness in the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources. We did not identify any risks of significant weakness.

4. Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Financial Reporting Council's Ethical Standard and confirm that we, as a firm, and each covered person, are independent and are able to express an objective opinion on the financial statements.

Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in May 2020 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

Details of fees charged are detailed in Appendix D.

Transparency

Grant Thornton publishes an annual Transparency Report, which sets out details of the action we have taken over the past year to improve audit quality as well as the results of internal and external quality inspections. For more details see [Transparency report 2020 \(grantthornton.co.uk\)](https://www.grantthornton.co.uk/transparency-report-2020)

Audit and non-audit services

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The following non-audit services were identified.

| Service | Proposed fees | Threats identified | Safeguards |
|--|---------------|--|--|
| Audit related | | | |
| Agreed upon procedures on the Council's Housing Benefit subsidy return | £11,500 | Self-Interest (because this is a recurring fee) | The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work is £11,500 in comparison to the total planned fee for the audit of £56,709 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors all mitigate the perceived self-interest threat to an acceptable level. |
| | | Self review (because GT provides audit services) | To mitigate against the self review threat, the timing of certification work is done after the audit has completed, materiality of the amounts involved to our opinion and unlikelihood of material errors arising and the Council has informed management who will decide whether to amend returns for our findings and agree the accuracy of our reports on grants. |

Appendices

A. Action plan – Audit of Financial Statements

We have identified the recommendations below for the Council as a result of issues identified during the course of our audit. We have agreed our recommendations with management and we will report on progress on these during the course of the 2022/23 audit. The matters reported here are limited to deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with auditing standards.

| Assessment | Issue and risk | Recommendations |
|----------------------|---|--|
| <p>Medium</p> | <p>Journal system controls</p> <p>Audit identified 6 members of the finance team who have 'level 9' access rights in the Civica system which allows them to edit and delete journals. One of these officers also has the access rights to edit and delete other people's journals as well as create new users. From an audit perspective therefore, journals entry user access rights did not have appropriate segregation of duties in 2021/22.</p> <p>We are aware of mitigating control that another user downloads a monthly report showing changes in user access rights including whether new users are created. There are also regular budget reviews to detect unusual posting.</p> <p>We have previously reported that the journal system uses retrospective authorisation of journals over £25k. We note that this only applies to journals with individual debit transactions over £25k, for example if a journal was made up of 26 lines of £1k, or credit balances over £25k, it would not be picked up in the authorisation reports. Management and Those Charged with Governance should note the risk of the unreviewed journals that do not meet this threshold.</p> <p>In response to this finding, the audit team increased the risk associated with journal entries, which doubled the size of the journals substantive testing sample, asked all journal posters whether they were asked to post anything unusual, reviewed the authorisation records of journals over £25k and obtained evidence of the monthly check by management on system user changes.</p> | <ul style="list-style-type: none"> • It should be considered whether individuals with system administration rights should also be finance team members who can post journals • There should be a review of users with 'level 9' access rights to ensure that this access is appropriate • It should be considered whether the out of system journal approval reports should also include journals with a total value greater than £25k should be reviewed as well as those with individual debit lines over £25k <p>Management response</p> <p>The Head of Finance and the S151 Officer have reviewed this risk and are happy that there are mitigating controls in place to address it. A review of users with 'level 9' access will be undertaken but it is not appropriate for officers with system administration rights to sit outside the finance team given our current structure and resourcing levels. We are happy with the mitigating control that an Accountant downloads a monthly report of changes in user access rights and new users.</p> <p>In terms of increasing the journal checks to all journals that total over £25k rather than individual debits over £25k this would create significant extra work for the team given the volume of journals input which would not be possible with the current resourcing levels. We have looked at the risk and the mitigating controls in place and feel that the position is robust enough to not warrant this extra work. The Council would have to employ at least one extra accountant to implement this recommendation and this is a low risk area and in the Council's view, the extra resource would not constitute value for money for local taxpayers. There are already compensating controls in place. In addition to the £25k journal checks by the Principal Accountants the Head of Finance reviews all cost centre balances over £30k once a quarter to ensure there are no rogue entries in the ledger both in terms of the detail of the spend but also compared to the budget. In addition the Accountants complete a mini closedown exercise at the end of September and December each year looking at the detail in every ledger code.</p> |

A. Action plan – Audit of Financial Statements

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| Assessment | Issue and risk | Recommendations |
|------------|--|--|
| <p>Low</p> | <p>Input data for valuations</p> <p>In five out of twenty four cases for sampled properties revalued in the year, evidence supporting the gross internal floor area (GIA) used in valuation calculations was obtained externally from the Valuation Office Agency or from third party advertising brochures.</p> <p>Currently, the only internal record we could be provided of measured surveys for certain assets is a value recorded within a spreadsheet. The assets team do not hold a record of who these measurements were taken by or when they were recorded, or other records such as drawings or floorplans to support this value. This would be best practice.</p> | <ul style="list-style-type: none"> • Management should consider whether the valuations for other land and buildings should be completed by an external expert in 2022/23 • Management should schedule a plan to complete measured surveys for all properties where GIA is a key input in valuation calculations • The surveys should be saved in a way that is accessible for corroboration and dated so that it is possible to check whether changes have taken place since the survey or need to be re-considered. <p>Management response</p> <p>The Council will consider whether the valuations for other land and buildings should be completed by an external expert in 2022/23.</p> <p>There would be a cost to this so this would be part of the overall consideration.</p> <p>The Council has measured surveys for all of its properties.</p> <p>We will ensure measured surveys are kept up to date by linking in with when properties are re-let and if any modifications take place and the Council will also schedule periodic measurements to confirm the existing data.</p> |

B. Follow up of prior year recommendations

We identified the following issue in the audit of South Hams District Council's 2020/21 financial statements, which resulted in 1 recommendation being reported in our 2020/21 Audit Findings report. We are pleased to report that management have responded to this finding and that the issue is now closed.

| Assessment | Issue and risk previously communicated | Update on actions taken to address the issue |
|------------|---|---|
| ✓ | <p>Ledger production of transaction reports</p> <p>Significant manual intervention has been required in previous years to produce transaction reports which reconcile to the trial balance and accounts rather than being able to pull these directly from the system</p> | <p>Management invested time before the fieldwork of the audit to ensure that the system reports were reconciled to the financial statements and ensuring that system reports could be obtained demonstrating how the ledger generates the accounts.</p> |

Assessment

- ✓ Action completed
- X Not yet addressed

C. Audit Adjustments

We are required to report all non trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management.

Misclassification and disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

| Issue | Adjusted? |
|---|-----------|
| Note 1 – disclosure added to explain uncertainty relating to useful lives for assets | ✓ |
| Note 13 - detail added clarifying observable inputs for level 2 fair value hierarchy measurement approach | ✓ |
| Note 12 - when agreeing the fixed asset register to the accounts, it was identified that costs relating to expenditure on the housing development at St Anne’s Chapel were included in land and building additions but as the projects are not complete these should be classified as assets under construction additions (£327k) | ✓ |
| Various small wording and typo adjustments in the narrative statement and accounting policies | ✓ |

C. Audit Adjustments



Impact of unadjusted misstatements

The table below provides details of adjustments identified during the 2021/22 audit which have not been made within the final set of financial statements. The Audit and Governance Committee is required to approve management's proposed treatment of all items recorded within the table below.

| Detail | Comprehensive Income and Expenditure Statement | Balance Sheet | Reason for not adjusting |
|--|--|--|---|
| As we have reported in previous years, the Council's investments with CCLA are designated as Fair Value through Other Comprehensive Income (FVOCI). The terms of the agreement allow redemption on demand and in our view the investment does not therefore meet the designation criteria to be held as FVOCI under IFRS 9. At 31 March 2022 the CCLA investments total £3.6m. | <u>In year</u> | No change to total usable or unusable reserves | Individually and cumulatively not material No impact on GF |
| | Dr Other Comprehensive Income and Expenditure £325k | | |
| In our view, the investment should be classified as Fair Value through Profit and Loss. The annual gain in value of £325k has been incorrectly credited to Other Comprehensive Income rather than the Surplus or Deficit on the Provision of Services in the Comprehensive Income and Expenditure Statement. There is currently a Statutory Override in place that allows Fair Value movements to be reversed to an unusable reserve so there would continue to be no impact on the General Fund from this reclassification. | Cr (Surplus) of Deficit on Provision of Services £325k | | |
| | <u>Cumulative</u> | | |
| | Dr Other Comprehensive Income and Expenditure £105k | | |
| | Cr (Surplus) of Deficit on Provision of Services £105k | | |

Unadjusted misclassification and disclosure changes

We discussed with management how the remuneration expense reported includes the full South Hams District Council pay expenditure and also the amounts re-charged from West Devon Borough Council. As the Council does not net off the portion of SHDC remuneration recharged to WDDBC, the employee costs are inflated. This is not an error because it is showing gross cost, with income for the recharge recognised on a separate line. However, a note or explanation could be added to show what the actual employee remuneration expense is once the recharges are taken into account.

D. Fees

We confirm below our expected fees charged for the audit and provision of non-audit services.

The fees recorded here reconcile to the financial statements.

| Audit fees | Proposed fee | Final fee |
|-------------------|---------------------|------------------|
| Council Audit | £56,709 | TBC* |

| Non-audit fees for other services | Proposed fee | Final fee |
|---|---------------------|------------------|
| Audit Related Services | | |
| Certification of Housing Benefits grant | £11,500** | TBC* |
| Total non-audit fees (excluding VAT) | £11,500 | TBC* |

*Final fees are yet to be confirmed as our work on VFM is not yet complete and Government guidance on accounting for infrastructure assets remains unavailable.

** Covers the base cost of this work. Additional errors identified are agreed with the Council and in accordance with the requirements of the DWP, additional testing is undertaken on each error. This additional testing is charged at £1,200 per set of additional tests (a set of additional tests being 40 cases or pro-rata if lower). In 2021/22 we are aware of 1 set of additional testing of a small population that will be required due to issues identified in our 2020/21 work. Further errors identified during our 2021/22 work will result in further additional costs. Therefore, at the planning stage we expect the cost will be roughly £200-£300 over £11,500. This may increase following completion of our work and we will report the final fee to the Audit and Governance Committee following the conclusion of our work.



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