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Informing the audit risk assessment for South Hams District 2019/20

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Purpose

The purpose of this report is to contribute towards the effective two-way communication between the Council's external auditors, Management and the Audit Committee, as 'those charged with governance'. The report covers some important areas of the auditor risk assessment where we are required to make inquiries of the Audit Committee under auditing standards.

Background

Under International Standards on Auditing (UK) (ISA(UK)) auditors have specific responsibilities to communicate with Audit Committee. ISA(UK) emphasise the importance of two-way communication between the auditor and the Audit Committee and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Audit Committee in understanding matters relating to the audit and developing a constructive working relationship. It also enables the auditor to obtain information relevant to the audit from the Audit Committee and supports the Audit Committee in fulfilling its responsibilities in relation to the financial reporting process.

Communication

As part of our risk assessment procedures we are required to obtain an understanding of management processes and the Council's oversight of the following areas:

- General Enquiries of Management
- Fraud,
- Laws and Regulations,
- Going Concern,
- Related Parties, and
- Accounting Estimates.

Purpose

This report includes a series of questions on each of these areas and the response we have received from the Council's management. The Audit Committee should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.

General Enquiries of Management

Question	Management response
1. What do you regard as the key events or issues that will have a significant impact on the financial statements for 2019/20?	<p>The Covid pandemic became prevalent in March 2020, near the year end date. This has had an impact on Fixed Asset Valuations with a Material Uncertainty shown in Note 1 'Assumptions made about the future and other major sources of estimation uncertainty'. This was due to Covid and the Council followed national guidance issued by RICS in its valuation. The Council purchased one Investment Property within 2019-20 for £5million.</p> <p>The Council also carried out a Senior Management Restructure during 2019/20 and the posts deleted and posts created are referred to in the Narrative Statement. This created savings of £60,000 for each Council.</p>
2. Have you considered the appropriateness of the accounting policies adopted by the Council? Have there been any events or transactions that may cause you to change or adopt new accounting policies?	<p>Yes the appropriateness has been considered – they are considered appropriate.</p> <p>No</p>
3. Is there any use of financial instruments, including derivatives?	<p>A summary of Financial Instruments carried on the Balance Sheet are shown in Note 14 to the Accounts. The Council has a £1.5m Investment with the CCLA Property Fund and a £2m Investment with the CCLA Diversified Income Fund.</p>
4. Is Are you aware of any significant transaction outside the normal course of business?	<p>No – see comments in Section 1 about the Covid pandemic in general.</p>

General Enquiries of Management

Question	Management response
5. Are you aware of any changes in circumstances that would lead to impairment of non-current assets?	No – see comments about Material Uncertainty due to the Covid 19 pandemic.
6. Are you aware of any guarantee contracts?	No. The main two contracts the Council has is for the delivery of waste services with FCC and for the delivery of leisure services with Fusion Leisure.
7. Are you aware of the existence of loss contingencies and/or un-asserted claims that may affect the financial statements?	No
8. Other than in house solicitors, can you provide details of those solicitors utilised by the Council during the year. Please indicate where they are working on open litigation or contingencies from prior years?	<p>Legal fees have been: £60,775 (15K on planning advice, £3K on public conveniences transfers to Parishes and £43K on general legal professional fees)</p> <p>And in addition:</p> <p>£56,014 legal advice and due diligence for renewable energy opportunities (solar farm)</p> <p>£21,796 for legal advice on various Community Housing projects</p> <p>£10,878 for the purchase of an Investment Property (Dartmouth M & S)</p> <p>£7,844 for legal advice on a Wholly Owned Company – Community Benefit Society (not yet set up)</p>
9. Have any of the Council's service providers reported any items of fraud, non-compliance with laws and regulations or uncorrected misstatements which would affect the financial statements?	No
10. Can you provide details of other advisors consulted during the year and the issue on which they were consulted?	<p>External advice was taken in HR on the Senior management review.</p> <p>Development specialists have advised on the future of Follaton House (HQ) and possible adaptations (e.g. opportunities for a wedding venue)</p>

Fraud

Issue

Matters in relation to fraud

ISA (UK) 240 covers auditors responsibilities relating to fraud in an audit of financial statements.

The primary responsibility to prevent and detect fraud rests with both the Audit Committee and management. Management, with the oversight of the Audit Committee, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of its oversight, the Audit Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As the Council's external auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error. We are required to maintain professional scepticism throughout the audit, considering the potential for management override of controls.

As part of our audit risk assessment procedures we are required to consider risks of fraud. This includes considering the arrangements management has put in place with regard to fraud risks including:

- assessment that the financial statements could be materially misstated due to fraud,
- process for identifying and responding to risks of fraud, including any identified specific risks,
- communication with the Audit Risk & Assurance Committee regarding its processes for identifying and responding to risks of fraud, and
- communication to employees regarding business practices and ethical behaviour.

We need to understand how the Audit Committee oversees the above processes. We are also required to make inquiries of both management and the Audit Committee as to their knowledge of any actual, suspected or alleged fraud. These areas have been set out in the fraud risk assessment questions below together with responses from the Council's management.

Fraud risk assessment

Question	Management response
<p>1. Have the Council assessed the risk of material misstatement in the financial statements due to fraud?</p> <p>How has the process of identifying and responding to the risk of fraud been undertaken and what are the results of this process?</p> <p>How do the Council's risk management processes link to financial reporting?</p>	<p>The Council's Audit Committee exercises overview of management's processes for identifying and reporting the risk of fraud and possible breaches of internal control for South Hams District Council.</p> <p>This is done through the following:</p> <p>Anti Fraud, Corruption and Bribery Policy and Strategy, and Anti-Money Laundering Policy:</p> <p>The Audit Committee considers and recommends to Council the approval of the Council's policies and zero tolerance position in relation to fraud and money laundering and monitors their use and any actions required to improve the control environment following alleged breaches.</p> <p>The System of Internal Audit: as described below, related reports to the Audit Committee include breaches of internal control and the Council's related Rules; Contract and Financial Procedure Rules as well as information on alleged fraud.</p> <p>The Senior Leadership Team consider it to be unlikely that the financial statements are materially misstated due to fraud.</p> <p>6 monthly reports on risk management are presented to the Council's Audit Committee. The risk management matrix used makes an assessment of the financial impact and the scoring is based on a range of financial impacts.</p>
<p>2. What have you determined to be the classes of accounts, transactions and disclosures most at risk to fraud?</p>	<p>The area most at risk of Fraud is Housing Benefit Fraud.</p>
<p>3. Are you aware of any instances of actual, suspected or alleged fraud, errors or other irregularities either within the Council as a whole or within specific departments since 1 April 2019?</p> <p>As a management team, how do you communicate risk issues (including fraud) to those charged with</p>	<p>Not within the Council or within Council departments.</p>

Fraud risk assessment

Question	Management response
<p>4. Have you identified any specific fraud risks?</p> <p>Do you have any concerns there are areas that are at risk of fraud?</p> <p>Are there particular locations within the Council where fraud is more likely to occur?</p>	<p>Housing Benefit fraud</p> <p>No specific concerns.</p> <p>No cash taken anymore – Council is cashless. Possibly within the depots for buildings maintenance. Internal audit controls in place.</p>
<p>5. What processes do the Council have in place to identify and respond to risks of fraud?</p>	<p>The Audit Committee receives a six monthly report on strategic risks. The Audit Committee also receives an annual report from the Statutory Officers' Panel (consisting of the Chief Executive, the S151 Officer and the Monitoring Officer) and one of the areas considered is Fraud. The Internal Audit Manager also reports on Fraud as part of his annual internal report to the Audit Committee.</p>
<p>6. How would you assess the overall control environment for the Council, including: the process for reviewing the effectiveness the system of internal control; internal controls, including segregation of duties; exist and work effectively?</p> <p>If not where are the risk areas and what mitigating actions have been taken?</p> <p>What other controls are in place to help prevent, deter or detect fraud?</p> <p>Are there any areas where there is a potential for override of controls or inappropriate influence over the financial reporting process (for example because of undue pressure to achieve financial targets)?</p>	<p>The Internal Control environment is reported on quarterly to the Audit Committee as part of the regular reporting of the Internal Audit Manager.</p> <p>A 'follow up' report is done on all internal audits on an annual basis also.</p> <p>Housing Benefit fraud is the highest risk area.</p> <p>See above</p> <p>None known of.</p>

Fraud risk assessment

Question	Management response
7. Are there any areas where there is potential for misreporting?	None known of to the S151 Officer.
<p>8. How do the Council communicate and encourage ethical behaviours and business processes of it's staff and contractors?</p> <p>How do you encourage staff to report their concerns about fraud?</p> <p>What concerns are staff expected to report about fraud?</p> <p>Have any significant issues been reported?</p>	<p>The Anti Fraud, Corruption and Bribery arrangements, whistle blowing policy and other ethical standards are publicised throughout the Council and to a wider audience outside through training, leaflets, the internal computer network and the Council's website etc.</p> <p>Reliance is placed on the process and the Council's Constitution, which includes the following: After consulting with the Head of Paid Service and the Monitoring Officer, the Section 151 Officer will report to the full Council and the Council's external auditor if it is considered that any proposal, decision or course of action will involve incurring unlawful expenditure, or is unlawful and is likely to cause a loss or deficiency or if the Council is about to enter an item of account unlawfully;</p> <p>After consulting with the Head of Paid Service and Section 151 Officer, the Monitoring Officer will report to the Full Council if it is considered that any proposal, decision or omission would give rise to unlawfulness or if any decision or omission has given rise to maladministration. Such a report will have the effect of stopping the proposal or decision being implemented until the report has been considered.</p> <p>There are processes in place to provide members of the Audit Committee, and other member bodies, with the assurance that when considering agenda items all relevant laws have been complied with, which includes: A formal system of consultation for all reports to member bodies, which includes advice on the legal implications from qualified solicitors and advice on financial implications by qualified accountants;</p> <p>All staff are recruited and regularly assessed against the Council's six IMPACT behaviours of Communicative, Responsible, Adaptable, Challenging, Co-operative and Outcome Focussed.</p>

Fraud risk assessment

Question	Management response
<p>11. What arrangements are in place to report fraud issues and risks to the Audit Committee? How does the Audit Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control? What has been the outcome of these arrangements so far this year?</p>	<p>The Audit Committee exercises overview of management's processes for identifying and reporting the risk of fraud and possible breaches of internal control for the Council. This is done through the following: Anti Fraud, Corruption and Bribery Policy and Strategy, and Anti-Money Laundering Policy: The Audit Committee considers and recommends to Council the approval of the Council's policies and zero tolerance position in relation to fraud and money laundering and monitors their use and any actions required to improve the control environment following alleged breaches. The System of Internal Audit: related reports to the Audit Committee include breaches of internal control and the Council's related Rules; Contract and Financial Procedure Rules as well as information on alleged fraud.</p> <p>No potential frauds have been reported to the Audit Committee during 2019/20.</p>
<p>12. Are you aware of any whistle blowing potential or complaints by potential whistle blowers? If so, what has been your response?</p>	<p>The S151 Officer is not aware of any.</p>
<p>13. Have any reports been made under the Bribery Act?</p>	<p>No</p>

Law and regulations

Issue

Matters in relation to laws and regulations

ISA (UK) 250 requires us to consider the impact of laws and regulations in an audit of the financial statements.

Management, with the oversight of the Audit Committee, is responsible for ensuring that the Council's operations are conducted in accordance with laws and regulations including those that determine amounts in the financial statements.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error, taking into account the appropriate legal and regulatory framework. As part of our risk assessment procedures we are required to make inquiries of management and the Audit Committee as to whether the entity is in compliance with laws and regulations. Where we become aware of information of non-compliance or suspected non-compliance we need to gain an understanding of the non-compliance and the possible effect on the financial statements.

Risk assessment questions have been set out below together with responses from management.

Impact of laws and regulations

Question	Management response
<p>1. How does management gain assurance that all relevant laws and regulations have been complied with?</p> <p>What arrangements does the Council have in place to prevent and detect non-compliance with laws and regulations? Are you aware of any changes to the Council's regulatory environment that may have a significant impact on the Council's financial statements?</p>	<p>Every Committee and Council report has to state the legal implications of the report and state the legal powers that are being used to make a decision.</p> <p>The Monitoring Officer and the S151 Officer review all reports that are published and reports are 'signed off' by these Statutory Officers.</p> <p>No – see comments about how Covid19 will affect valuations and a Material Valuation Uncertainty being given (following national RICS guidance).</p>
<p>2. How is the Audit Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>The Audit Committee receives a quarterly confirmation that there is no significant breach of law or internal rules.</p>
<p>3. Have there been any instances of non-compliance or suspected non-compliance with laws and regulation since 1 April 2019 with an on-going impact on the 2019/2020 financial statements?</p>	<p>No</p>
<p>4. Is there any actual or potential litigation or claims that would affect the financial statements?</p>	<p>No</p>

Impact of laws and regulations

Question	Management response
5. What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?	The S151 Officer and Monitoring Officer have quarterly meetings with the Chief Executive (Statutory Officers Panel) where any such items would be discussed. None known of.
6. Have there been any report from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	No – None known of.

Going Concern

Issue

Matters in relation to going concern

ISA (UK) 570 covers auditor responsibilities in the audit of financial statements relating to management's use of the going concern assumption in the financial statements.

The going concern assumption is a fundamental principle in the preparation of financial statements. Under this assumption entities are viewed as continuing in business for the foreseeable future. Assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

Going concern considerations have been set out below and management has provided its response.

Going concern considerations

Question	Management response
<p>1. Has the management team carried out an assessment of the going concern basis for preparing the financial statements for the Council? What was the outcome of that assessment?</p>	<p>Yes – the latest Month 3 revenue budget monitoring report presented to the Executive on 30th July showed an expected shortfall (loss) for 2020/21 of £1.3million.</p> <p>The S151 Officer is assured of the Council's Going Concern Status. Monthly monitoring is being undertaken by the finance team.</p> <p>Options for an Amended Budget for 2020-21 are being presented to Members in September. Utilising the £112,000 underspend from closing down the 2019/20 Accounts will be one of the options being presented to Members in September. Earmarked Reserves total £13.998m at 31.3.2020 and Unearmarked Reserves stand at £2.0 million.</p>
<p>2. Are the financial assumptions in that report (e.g., future levels of income and expenditure) consistent with the budget and the financial information provided to members throughout the year?</p>	<p>Yes – various assumptions are made about income levels from July onwards but actual losses for the first 3 months have been factored in.</p>

Going concern considerations

Question	Management response
3. Are the implications of statutory or policy changes appropriately reflected in the Council, financial forecasts and report on going concern?	No new statutory or policy changes known of – apart from the Government support package for Covid19 pandemic.
4. Have there been any significant issues raised with the Audit Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).	No none reported.
5. Does a review of available financial information identify any adverse financial indicators including negative cash flow or poor or deteriorating performance against the better payment practice code? If so, what action is being taken to improve financial performance?	Cash Flow continues to be positive. The Council is being proactive in chasing all debts with reminder letters having been sent for council tax arrears, business rates arrears and sundry debtors. These reminder letters are not automated from the system (as was the case before Covid) but have instead been personalised to the customer's situation e.g. claiming council tax support. The reminder letters offer help and support for addressing arrears and debts. Further reminder letters will be sent in future months regularly. Team Devon (all the Devon Councils) have agreed to co-ordinate approaches to debt recovery in terms of timings and key messages.

Going concern considerations

Question	Management response
<p>6. Does the Council have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Council's objectives? If not, what action is being taken to obtain those skills?</p>	<p>Yes – the Senior Management Team has been recently recruited to. The Chief Executive is new in post in July 2020 but has a wealth of experience from being the South West Lead Adviser for the LGA.</p>
<p>7. Does the Council have procedures in place to assess their ability to continue as a going concern?</p>	<p>Yes – monthly budget monitoring reports – also sets out the Government support package and the Government's 'income guarantee' scheme. Amended Budget will be set by Council in September 2020. Recovery and Renewal Plan re. Covid and 'Build Back Better' initiative will be taken to Council also in September 2020 for approval. Revised MTFS in October 2020.</p>
<p>8. Is management aware of the existence of events or conditions that may cast doubt on the Council's ability to continue as a going concern?</p>	<p>None aware of.</p>

Going concern considerations

Question	Management response
<p>9. Are arrangements in place to report the going concern assessment to the Audit Committee ?</p> <p>How has the Audit Committee satisfied itself that it is appropriate to adopt the going concern basis in preparing financial statements?</p>	<p>Monthly revenue budget monitoring reports are reported to the Executive on a monthly basis. The accounts set out elements of the going concern assessment such as the level of Unearmarked and Earmarked Reserves.</p> <p>An amended Budget for 2020-21 will be agreed by Council in September 2020. This will be done on a virement basis of how the budget shortfall of £1.3m will be met.</p>

Related Parties

Issue

Matters in relation to Related Parties

the Council are required to comply with IAS 24 and disclose transactions with entities/individuals that would be classed as related parties. These may include:

- entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the Council;
- associates;
- joint ventures;
- an entity that has an interest in the authority that gives it significant influence over the Council;
- key management personnel, and close members of the family of key management personnel, and
- post-employment benefit plans (pension fund) for the benefit of employees the Council, or of any entity that is a related party of the Council.

A disclosure is required if a transaction (or series of transactions) is material on either side, i.e. if a transaction is immaterial from the Council perspective but material from a related party viewpoint then the Council must disclose it.

ISA (UK) 550 requires us to review your procedures for identifying related party transactions and obtain an understanding of the controls that you have established to identify such transactions. We will also carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate.

Relating Parties

Question	Management response
1. What controls does the Council have in place to identify, account for and disclose related party transactions and relationships ?	All Members and all of the Senior Leadership Team are required to complete a Related Parties Return in April 2020 following the Year End. Items disclosed on these returns are reviewed by the Finance Head of Practice, to assess whether they need to be disclosed within the Financial Statements.

Accounting estimates

Issue

Matters in relation to Related Accounting estimates

the Council apply appropriate estimates in the preparation of their financial statements. ISA (UK) 540 sets out requirements for auditing accounting estimates. The objective is to gain evidence that the accounting estimates are reasonable and the related disclosures are adequate.

Under this standard we have to identify and assess the risks of material misstatement for accounting estimates by understanding how the Combined Authority identifies the transactions, events and conditions that may give rise to the need for an accounting estimate.

Accounting estimates are used when it is not possible to measure precisely a figure in the accounts. We need to be aware of all estimates that the Combined Authority is using as part of its accounts preparation; these are detailed in appendix 1 to this report. The audit procedures we conduct on the accounting estimate will demonstrate that:

- the estimate is reasonable; and
- estimates have been calculated consistently with other accounting estimates within the financial statements.

We would ask the Audit Committee to satisfy itself that the arrangements for accounting estimates are adequate.

Accounting Estimates

Question	Management response
1. Are management aware of transactions, events, conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgement (other than those in Appendix A)?	None known of by the S151 Officer.
2. Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable?	Yes and these have not changed from the previous year.
3. How is the Audit Committee provided with assurance that the arrangements for accounting estimates are adequate ?	Very little use of accounting estimates within the Financial Statements. De-minimis levels are set out clearly within the accounting policies. Note 1 to the Accounts sets out in detail the 'Other Major Sources of Estimation Uncertainty'.

Appendix A Accounting Estimates

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Property, plant & equipment valuations	Fair value for land/buildings defined as 'existing use' by the Council.	Valuations are performed annually to ensure that the fair value of a revalued asset does not differ materially from its carrying amount. For land and buildings all material assets will be considered in 2019/20.	the Council	Degree of uncertainty inherent with any revaluation. We employ professional valuers and rely on expert opinion.	No
Estimated remaining useful lives of PPE	Each part of an item of property, plant and equipment with a significant cost in relation to the total cost is depreciated separately. Depreciation methods, useful lives and residual values are reviewed each financial year and adjusted if appropriate.	See left box	Discussion with internal asset team and where applicable the Council as the valuer.	Depreciation is calculated on a straight line basis as this reflects consumption of assets and is a reasonable assumption.	No

Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Depreciation and Amortisation	See above	See above	See above	See above	No
Impairments	Review of all assets undertaken annually in line with the Council.	See left.	Discussion with internal asset team as appropriate.	N/A.	No.
Measurement of Financial Instruments	Financial instruments consist of investments (Collective Investment Fund (CIF)). Measured initially at cost and subsequently at amortised cost using the effective interest method.	Knowledge by the Investment team who manages the CIF portfolio in assessing the potential risk in credit losses.	Fund advisers – the Council	The CIF portfolio is assessed on an individual borrower for its expected credit losses using: i) Probability of default ii) Loss of given default	No

Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Provisions for liabilities	Provisions are identified through detailed monthly management accounts which flags any potential issues to management.	Each provision is separately reviewed by financial accounts and a working is put together to support the calculation.	As necessary on an individual basis	Each provision is assessed on an individual basis to ensure that it meets the criteria of a provision per IAS 37. The degree of uncertainty is assessed when determining whether a provision is the correct treatment for an item.	No.
Bad Debt Provision	Debts are reviewed monthly and any debts that are deemed to be irrecoverable are written off to the Council.	Knowledge by the Accounts Receivables team in likelihood of recoverability and the aging of the debts. the Council signs off the write off.	N/A	N/A	No.

Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Accruals	We use standard accruals accounting –accruals are based on expenses incurred that have not yet been paid.	Monthly management accounts provides rigorous analysis so that any accruals are highlighted and actioned throughout the year.	N/A.	N/A.	No.
Non Adjusting events – events after the balance sheet date	Monthly management accounts prepared would flag any adjusting/non-adjusting events.	See left.	N/A.	N/A.	No.

Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Pension Fund (LGPS) Actuarial gains/losses	The actuarial gains and losses figures are calculated by the actuarial expert the Council. These figures are based on making % adjustments to the closing values of assets/liabilities.	the Council responds to queries raised by the administering body, the Council.	the Council are provided with an actuarial report by the Council (LGPS).	The nature of these figures forecasting into the future are based upon the best information held at the current time and are developed by experts in their field.	No.



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