

# The Audit Findings for Mid Devon District Council

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Year ended 31 March 2019

15 July 2019



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The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose all defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify. 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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# Headlines

This table summarises the key findings and other matters arising from the statutory audit of Mid Devon District Council ('the Council') and the preparation of the Group and Council's financial statements for the year ended 31 March 2019 for those charged with governance.

<b>Financial Statements</b>	<p>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 group and Council's financial statements:</p> <ul style="list-style-type: none"><li>• give a true and fair view of the financial position of the group and Council's income and expenditure for the year; and</li><li>• 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.</li></ul> <p>We are also required to report whether other information published together with the audited financial statements (including the Annual Governance Statement (AGS), 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>Our audit work was completed on site during May and June. Our findings are summarised on pages 5 to 15. We have identified no adjustments to the financial statements affecting the Council's Comprehensive Income and Expenditure Statement. Other audit adjustments 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.</p> <p>Our work is substantially complete and there are no matters of which we are aware that would require modification of our audit opinion or material changes to the financial statements, subject to the following outstanding matters;</p> <ul style="list-style-type: none"><li>• receipt of management representation letter,</li><li>• review of the final set of financial statements,</li><li>• receipt of our letter of assurance from the Devon County Pension Fund auditor,</li><li>• updating our subsequent event review,</li><li>• Finalisation of reporting on the McCloud judgement, and</li><li>• Review of the Council's final Annual Governance Statement and final review of the narrative statement.</li></ul> <p>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 will be unmodified.</p>
<b>Value for Money arrangements</b>	<p>Under the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report if, in our opinion, the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources ('the value for money (VFM) conclusion').</p>	<p>We have completed our risk based review of the Council's value for money arrangements. We have concluded that Mid Devon District Council has proper arrangements to secure economy, efficiency and effectiveness in its use of resources, except for its arrangements in relation to its commercial activities with 3 Rivers Development Ltd. This affects the following VFM criteria:</p> <ul style="list-style-type: none"><li>• Acting in the public interest, through demonstrating and applying the principles and values of sound governance,</li><li>• understanding and using appropriate and reliable financial and performance information to support informed decision making and performance management including where relevant, business cases supporting significant investment decisions, and</li><li>• Managing risks effectively and maintaining a sound system of internal control.</li></ul> <p>We therefore anticipate issuing a qualified 'except for' value for money conclusion. Our findings are summarised later in VFM section of this report.</p>

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# Headlines (continued)

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## 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 have completed the majority of work under the Code and expect to be able to certify the completion of the audit when we give our audit opinion.

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## Acknowledgements

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

# Summary

## 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 and Group'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;

- An evaluation of the components of the group based on a measure of materiality considering each as a percentage of various Group accounts balances to assess the significance of the component and to determine the planned audit response. In our Audit Plan we set out that 3 Rivers Development Ltd was not expected to be a significant component and that our planned response was to be analytical procedures. On receipt of the draft statements we re-evaluated this and due to the level of current liabilities at 3 Rivers Development Ltd, the component was assessed as significant. Our work on the group therefore focused on agreeing consolidation adjustments and testing of material balances after consolidation adjustments, that is, substantive testing of £2.1m work in progress.
- Substantive testing on significant transactions and material account balances, including the procedures outlined in this report in relation to the key audit risks.

We have not had to alter or change our audit plan, as communicated to you on 22 January 2019, except for group response detailed above.

## Conclusion

We have substantially completed our audit of your financial statements and subject to outstanding queries being resolved, we anticipate issuing an unqualified audit opinion following the Audit Committee meeting on 15 July 2019. These outstanding items are set out on page 3 of this report.

## 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.

Our assessment of the value of materiality has been adjusted from that set out in our Audit Plan. This was not due to an increase in perceived risk but rather to reflect the increase in the Council's and Group's Gross Revenue Expenditure upon receipt of the draft financial statements. We detail in the table below our determination of materiality for Mid Devon District Council and the Group.

	Group Amount (£)	Council Amount (£)
Materiality for the financial statements	1,006,000	1,006,000
Performance materiality	755,000	755,000
Trivial matters	50,300	50,300
Materiality for Senior Officer remuneration	5,000	5,000

# Significant findings – audit risks

Risks identified in our Audit Plan	Commentary
<p><b>1</b> <b>Improper revenue recognition</b></p> <p>Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. 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><b>Auditor commentary</b></p> <p>In our Audit Plan we set out that having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Council, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because:</p> <ul style="list-style-type: none"> <li>• there is little incentive to manipulate revenue recognition</li> <li>• opportunities to manipulate revenue recognition are very limited</li> <li>• the culture and ethical frameworks of local authorities, including Mid Devon District Council, mean that all forms of fraud are seen as unacceptable</li> </ul> <p>Therefore we concluded that we do not consider this to be a significant risk for Mid Devon District Council.</p> <p>We have re-assessed this conclusion throughout our audit and have concluded that there has been no change to our assessment reported in the audit plan.</p> <p>Whilst our testing did not identify any issues in relation to improper revenue recognition, our expenditure testing identified three items totalling £553 where revenue items had been coded to expenditure. The impact of this is to understate both revenue and expenditure. From the follow up work we have completed we are assured that the impact of this would not be material, however this does highlight a weakness in controls. We have therefore recommended that the Council review procedures for coding income to ensure that income items are coded and classified correctly – this recommendation and management’s response can be seen in the action plan at Appendix A.</p>
<p><b>2</b> <b>Management override of controls</b></p> <p>Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.</p> <p>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.</p>	<p><b>Auditor commentary</b></p> <p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> <li>• reviewed accounting estimates, judgements and decisions made by management,</li> <li>• tested journal entries,</li> <li>• reviewed unusual significant transactions, and</li> <li>• reviewed significant related party transactions outside the normal course of business.</li> </ul> <p>Our audit work has not identified any issues in respect of management override of controls.</p>

# Significant findings – audit risks

## Risks identified in our Audit Plan

## Commentary

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### Valuation of land and buildings

The Council revalues its land and buildings on an annual basis to ensure that the carrying value is not materially different from the current value at the financial statements date. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved (£197 million – Net Book Value) and the sensitivity of this estimate to changes in key assumptions.

Management have engaged the services of a valuer to estimate the current value as at 31 March 2019.

We therefore identified valuation of land and buildings, particularly revaluations, as a significant risk, which was one of the most significant assessed risks of material misstatement, and a key audit matter.

### Auditor commentary

We have undertaken the following work in relation to this risk:

- Review of management's processes and assumptions for the calculation of the estimate.
- Review of the competence, expertise and objectivity of any management experts used.
- Review of the instructions issued to valuation experts and the scope of their work
- Discussions with the Council's valuer about the basis on which the valuation was carried out, challenging the key assumptions.
- Review and challenge of the information used by the valuer to ensure it was robust and consistent with our understanding.
- Testing of revaluations made during the year to ensure they were input correctly into the Council's asset register
- Evaluation of the assumptions made by management for those assets not revalued during the year and how management satisfied themselves that these were not materially different to current value.

Our work has not identified any issues in relation to the valuation of land and buildings.

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### 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 and group accounts.

The pension fund net liability is considered a significant estimate due to the size of the numbers involved (£60 million in the Council's balance sheet) and the sensitivity of the estimate to changes in key assumptions.

We therefore identified valuation of the Council's pension fund net liability as a significant risk, which was one of the most significant assessed risks of material misstatement, and a key audit matter.

### Auditor commentary

We have undertaken the following work in relation to this risk:

- Identified the controls put in place by management to ensure that the pension fund net liability is not materially misstated and assessed whether those controls were implemented as expected and whether they were sufficient to mitigate the risk of material misstatement.
- Review of the competence, expertise and objectivity of the actuary who carried out the Council's pension fund valuation.
- Gaining an understanding of the basis on which the IAS 19 valuation was carried out, undertaking procedures to confirm the reasonableness of the actuarial assumptions made.
- Review of the consistency of the pension fund net liability disclosures in notes to the financial statements with the actuarial report from your actuary.

Although our audit work set out above has not identified any issues in respect of this risk, discussion is ongoing in the sector regarding the potential impact of the McCloud judgement. The Council have discussed this with their Actuary, Barnett Waddingham and the potential impact is set out on page 9 of this report.

# Significant findings arising from the group audit

Component	Component auditor	Findings	Group audit impact
<b>3 Rivers Development Limited</b>	N/A	<p>As set out on page 3 of this report we were required to change our planned approach to auditing the group financial statements. This was due to:</p> <p>The level of current liabilities held by the company in relation to the overall group balance, however, these were cancelled out on consolidation as they were loans from the Council.</p> <p>On consolidation an additional £2.1m of work in progress was included on the group balance sheet which is not included in the Councils balance sheet. We carried out sample testing of this balance and identified no issues.</p> <p>In relation to the loans to the company we reviewed the Councils assertion that no impairment was required under IFRS9 and the expected credit loss model – we concluded that the Council's assessment that no impairment was required was reasonable.</p> <p>We carried out a detailed review of the group disclosure requirements and identified a number of areas where further disclosure was required.</p>	<p>The key findings and adjustments were in relation to:</p> <ul style="list-style-type: none"> <li>• The addition of group accounting policies,</li> <li>• The addition of an additional note explaining work in progress and,</li> <li>• Additional disclosures in relation to the valuation basis of 3 Rivers investment property.</li> </ul>





# Significant findings - other issues





This section provides commentary on new issues and risks which were identified during the course of the audit that were not previously communicated in the Audit Plan and a summary of any significant control deficiencies identified during the year.

Issue	Commentary	Auditor view
<p><b>1 Potential impact of the McCloud judgement</b></p> <p>The Court of Appeal has ruled that there was age discrimination in the judges and firefighters pension schemes where transitional protections were given to scheme members.</p> <p>The Government applied to the Supreme Court for permission to appeal this ruling, but this permission to appeal was unsuccessful. The case will now be remitted back to employment tribunal for remedy.</p> <p>The legal ruling around age discrimination (McCloud - Court of Appeal) has implications not just for pension funds, but also for other pension schemes where they have implemented transitional arrangements on changing benefits.</p>	<p>Discussion is ongoing in the sector regarding the potential impact of the ruling on the financial statements of Local Government bodies.</p> <p>The Council has requested an estimate from its actuary of the potential impact of the McCloud ruling. The actuary's estimate was of a possible increase in pension liabilities of £945k, and an increase in service costs for the 2019/20 year of £103k.</p> <p>Management's view is that the impact of the ruling is not material for Mid Devon District Council, and will be considered for future years' actuarial valuations.</p>	<p>We have reviewed the analysis performed by the actuary, and consider that the approach that has been taken to arrive at this estimate is reasonable.</p> <p>Although we are of the view that there is sufficient evidence to indicate that a liability is probable, we have satisfied ourselves that there is not a risk of material error as a result of this issue. We also acknowledge the significant uncertainties relating to the estimation of the impact on the Council's liability.</p> <p>We have included this as an uncertainty within Appendix C.</p>


# Significant findings – key judgements and estimates

Accounting area	Summary of management's policy	Audit Comments	Assessment
<b>Provisions for NNDR appeals - £0.347m</b>	The Council are responsible for repaying a proportion of successful rateable value appeals. Management have not changed their approach to calculate the level of provision required. Appeals have stayed constant over recent years and the Council continues to take a prudent approach.	<p>We have carried out the following work in relation to this estimate:</p> <ul style="list-style-type: none"> <li>Reviewed the reasonableness of estimate, and</li> <li>Reviewed the adequacy of disclosure of estimate in the financial statements.</li> </ul>	
<b>Land and Buildings – Council Housing - £145.8m</b>	The Council owns 3,003 dwellings and is required to revalue these properties in accordance with DCLG's Stock Valuation for Resource Accounting guidance. The guidance requires the use of beacon methodology, in which a detailed valuation of representative property types is then applied to similar properties. The Council has engaged the District Valuer to complete the valuation of these properties. The year end valuation of Council Housing was c£146m.	<p>We have carried out the following work in relation to this estimate:</p> <ul style="list-style-type: none"> <li>Assessed management's expert to ensure suitably qualified and independent,</li> <li>Assessed the completeness and accuracy of the underlying information used to determine the estimate,</li> <li>Confirmed there were no changes to valuation method</li> <li>Assessed the consistency of the estimate against near neighbours and using the Gerald Eve report, and</li> <li>Assessed the adequacy of disclosure of the estimate in the financial statements.</li> </ul>	

## Assessment

-  We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
-  We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
-  We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
-  We consider management's process is appropriate and key assumptions are neither optimistic or cautious

# Significant findings – key judgements and estimates

	Summary of management's policy	Audit Comments	Assessment
<b>Land and Buildings – Other - £43.835m</b>	<p>Other land and buildings comprises c£43m of specialised assets, 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 Council has engaged the District Valuer to complete the valuation of properties as at 31 March 2019 on a five yearly cyclical basis. c20% of total assets were revalued during 2018/19. The valuation of properties valued by the valuer has resulted in a net decrease of £0.622m. Management have considered the year end value of non-valued properties, to determine whether there has been a material change in the total value of these properties. Management's assessment of assets not revalued has identified no material change to the properties values. The total year end valuation of Other land and buildings was £43.835m, a net decrease of £0.622m from 2017/18 (£44.457m).</p>	<p>We have carried out the following work in relation to this estimate:</p> <ul style="list-style-type: none"> <li>Assessed management's expert to ensure suitably qualified and independent,</li> <li>Assessed the completeness and accuracy of the underlying information used to determine the estimate,</li> <li>Confirmed there were no changes to valuation method</li> <li>Assessed the consistency of the estimate against near neighbours and using the Gerald Eve report, and</li> <li>Assessed the adequacy of disclosure of the estimate in the financial statements.</li> </ul>	

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# Significant findings – key judgements and estimates

Summary of management's policy	Audit Comments	Assessment																									
<b>Net pension liability – £59.379m</b>	<p>The Council's total net pension liability at 31 March 2019 is £59.379m (PY £60.009m). The Council uses Barnett Waddingham to provide actuarial valuations of the Council's assets and liabilities derived from the Devon County Pension Fund. A full actuarial valuation is required every three years. The latest full actuarial valuation was completed in 2016. A roll forward approach is used in intervening periods, which utilises key assumptions such as life expectancy, discount rates, salary growth and investment returns. Given the significant value of the net pension fund liability, small changes in assumptions can result in significant valuation movements. There has been a £0.630m net actuarial gain during 2018/19.</p>	<p>We have carried out the following work in relation to this estimate:</p> <ul style="list-style-type: none"> <li>Assessed management's expert to ensure suitably qualified and independent,</li> <li>Assessed the actuary's roll forward approach taken,</li> <li>We have used PwC as auditors expert to assess actuary and assumptions made by actuary. The table below summarises where Mid Devon fall in the acceptable ranges set by PwC:</li> </ul>																									
<table border="1"> <thead> <tr> <th data-bbox="795 482 1245 554">Assumption</th> <th data-bbox="1245 482 1411 554">Actuary Value</th> <th data-bbox="1411 482 1622 554">PwC range</th> <th data-bbox="1622 482 1798 554">Assessment</th> </tr> </thead> <tbody> <tr> <td data-bbox="795 554 1245 608">Discount rate</td> <td data-bbox="1245 554 1411 608">2.4%</td> <td data-bbox="1411 554 1622 608">2.35 – 2.45%</td> <td data-bbox="1622 554 1798 608">●</td> </tr> <tr> <td data-bbox="795 608 1245 662">Pension increase rate</td> <td data-bbox="1245 608 1411 662">2.4%</td> <td data-bbox="1411 608 1622 662">2.40 – 2.45%</td> <td data-bbox="1622 608 1798 662">●</td> </tr> <tr> <td data-bbox="795 662 1245 733">Salary growth</td> <td data-bbox="1245 662 1411 733">3.9%</td> <td data-bbox="1411 662 1622 733">3.10 – 4.35%</td> <td data-bbox="1622 662 1798 733">●</td> </tr> <tr> <td data-bbox="795 733 1245 805">Life expectancy – Males currently aged 45 / 65</td> <td data-bbox="1245 733 1411 805">22.4</td> <td data-bbox="1411 733 1622 805">22.2 – 25.0</td> <td data-bbox="1622 733 1798 805">●</td> </tr> <tr> <td data-bbox="795 805 1245 886">Life expectancy – Females currently aged 45 / 65</td> <td data-bbox="1245 805 1411 886">24.4</td> <td data-bbox="1411 805 1622 886">23.3 – 24.8</td> <td data-bbox="1622 805 1798 886">●</td> </tr> </tbody> </table>				Assumption	Actuary Value	PwC range	Assessment	Discount rate	2.4%	2.35 – 2.45%	●	Pension increase rate	2.4%	2.40 – 2.45%	●	Salary growth	3.9%	3.10 – 4.35%	●	Life expectancy – Males currently aged 45 / 65	22.4	22.2 – 25.0	●	Life expectancy – Females currently aged 45 / 65	24.4	23.3 – 24.8	●
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<ul style="list-style-type: none"> <li>We have gained assurance over the completeness and accuracy of the underlying information used to determine the estimate,</li> <li>We have gained assurance over the reasonableness of the Council's share of LGPS pension assets, and</li> <li>We have reviewed the adequacy of disclosure of the estimate in the financial statements.</li> </ul>																											

## Assessment

- We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
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- We consider management's process is appropriate and key assumptions are neither optimistic or cautious

# Going concern

## 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).

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## Going concern commentary

### Management's assessment process

Management have carried out a detailed assessment of the Council's ability to continue as a going concern. This process included undertaking a detailed cash flow forecast through to July 2020. As part of this assessment management have considered their general fund and earmarked reserves balances as well as their net current asset position on their balance sheet.

### Auditor commentary

- We have concluded that management's process is adequate, and that the assessment is supported by robust assumptions.

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### Work performed

We have:

- discussed with management the financial standing of the Council;
- reviewed and challenged management's assessment of going concern assumptions and supporting information, e.g. medium term financial planning assumptions and cash flow forecasts;
- reviewed savings targets over the medium term as part of drawing our VFM conclusion.

### Auditor commentary

- We have reviewed managements assessment and have not identified any issues that would lead us to believe that there is a material uncertainty in the Council's assumption in preparing the financial statements on a going concern basis.

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### Concluding comments

Following our review we are satisfied with management's assessment of use of going concern basis of accounting.

### Auditor commentary

- Based on the work completed we plan to issue an unmodified audit opinion in relation to going concern.
- Our audit work detailed in the VFM section of this report provides more commentary regarding the financial challenge faced by the Council.

# 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
① <b>Matters in relation to fraud</b>	<ul style="list-style-type: none"> <li>We have previously discussed the risk of fraud with the Audit 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.</li> </ul>
② <b>Matters in relation to related parties</b>	<ul style="list-style-type: none"> <li>We are not aware of any related parties or related party transactions which have not been disclosed.</li> </ul>
③ <b>Matters in relation to laws and regulations</b>	<ul style="list-style-type: none"> <li>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.</li> </ul>
④ <b>Written representations</b>	<ul style="list-style-type: none"> <li>A letter of representation has been requested from the Council which is included in the Audit Committee papers.</li> </ul>
⑤ <b>Confirmation requests from third parties</b>	<ul style="list-style-type: none"> <li>We requested from management permission to send confirmation request(s) to banks and financial institutions with which the Council have investments. This permission was granted and the requests were sent. We have received positive confirmations in all cases.</li> </ul>
⑥ <b>Disclosures</b>	<ul style="list-style-type: none"> <li>Our review found no material omissions in the financial statements.</li> </ul>
⑦ <b>Audit evidence and explanations/significant difficulties</b>	<ul style="list-style-type: none"> <li>All information and explanations requested from management were provided.</li> </ul>

# Other responsibilities under the Code

Issue	Commentary
① <b>Other information</b>	<p>We are required to give an opinion on whether the other information published together with the audited financial statements (including the Statement of Accounts, 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.</p> <p>No inconsistencies have been identified. We plan to issue an unqualified opinion in this respect.</p>
② <b>Matters on which we report by exception</b>	<p>We are required to report on a number of matters by exception in a numbers of areas:</p> <ul style="list-style-type: none"> <li>• If the Annual Governance Statement does not meet the disclosure requirements set out in the CIPFA/SOLACE guidance or is misleading or inconsistent with the other information of which we are aware from our audit</li> <li>• If we have applied any of our statutory powers or duties</li> </ul> <p>We have nothing to report on these matters.</p>
③ <b>Specified procedures for Whole of Government Accounts</b>	<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>No detailed work is required in this area as the Council is below the thresholds set by the NAO.</p>
④ <b>Certification of the closure of the audit</b>	<p>We intend to certify the closure of the 2018/19 audit of Mid Devon District Council in our audit opinion.</p>

# Value for Money

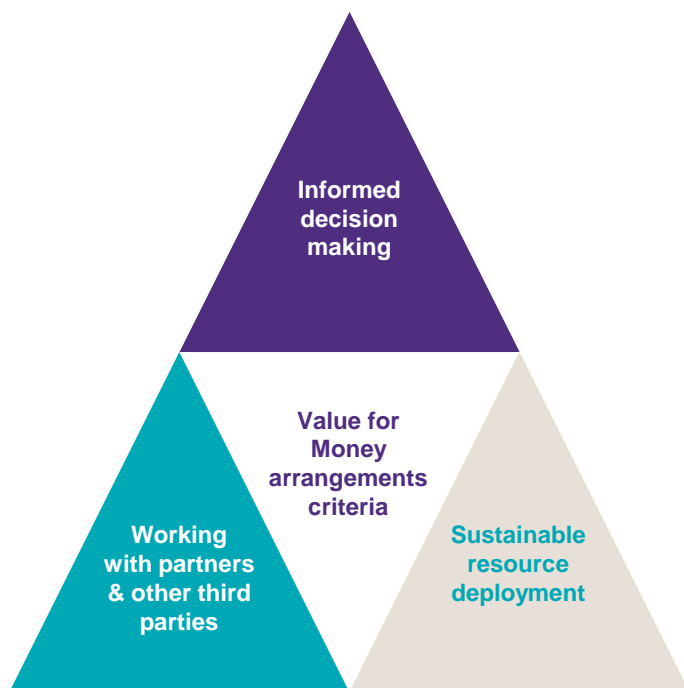
## Background to our VFM approach

We are required to satisfy ourselves that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the Value for Money (VFM) conclusion.

We are required to carry out sufficient work to satisfy ourselves that proper arrangements are in place at the Council. In carrying out this work, we are required to follow the NAO's Auditor Guidance Note 3 (AGN 03) issued in November 2017. AGN 03 identifies one single criterion for auditors to evaluate:

*"In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people."*

This is supported by three sub-criteria, as set out below:



## Risk assessment

We carried out an initial risk assessment in December 2018 and identified a number of significant risks in respect of specific areas of proper arrangements using the guidance contained in AGN03. We communicated these risks to you in our Audit Plan dated 22 January 2019.

We have continued our review of relevant documents up to the date of giving our report, and have not identified any further significant risks where we need to perform further work.

We carried out further work only in respect of the significant risks we identified from our initial and ongoing risk assessment. Where our consideration of the significant risks determined that arrangements were not operating effectively, we have used the examples of proper arrangements from AGN 03 to explain the gaps in proper arrangements that we have reported in our VFM conclusion.



# Value for Money

## **Our work**

AGN 03 requires us to disclose our views on significant qualitative aspects of the Council's arrangements for delivering economy, efficiency and effectiveness.

We have focused our work on the significant risks that we identified in the Council's arrangements. In arriving at our conclusion, our main considerations were:

- Financial outturn position and medium term financial plan;
- Arrangements for delivering and monitoring savings plans;
- Information provided to members for decision making in relation to the ongoing funding of 3 Rivers Development Limited;
- Arrangements for monitoring the performance of 3 Rivers Development Limited, and
- Internal Audit's work on its Group Governance arrangements.

We have set out more detail on the risks we identified, the results of the work we performed, and the conclusions we drew from this work on the following pages.

## **Overall conclusion**

Based on the work we performed to address the significant risks, we are satisfied that the Council had proper arrangements for securing economy, efficiency and effectiveness in its use of resources, except for the matter we identified in respect of Group Governance. We therefore propose to give a qualified 'except for' conclusion.

## **Recommendations for improvement**

We discussed findings arising from our work with management and have agreed recommendations for improvement.

Our recommendations and management's response to these can be found in the Action Plan at Appendix A

## **Significant difficulties in undertaking our work**

We did not identify any significant difficulties in undertaking our work on your arrangements which we wish to draw to your attention.

## **Significant matters discussed with management**

There were no matters where no other evidence was available or matters of such significance to our conclusion or that we required written representation from management or those charged with governance.

## Key findings

We set out below our key findings against the significant risks we identified through our initial risk assessment and further risks identified through our ongoing review of documents.

Significant risk	Findings	Conclusion
<p><b>1 Financial resilience</b></p> <p>Like the majority of councils, Mid Devon District Council faces a significant financial challenge over the medium term. The Council is forecasting an overspend of £181k in 2018/19 and has a funding gap of £1.4m through to 2021/22. The Council currently has a General Fund Reserve of £2.241m, which is above the approved minimum level of £2.1m. Without action, the Council's General Fund Reserves will be eroded by 2020/21.</p> <p>In response to this risk we have reviewed the significant assumptions made in the Council's medium term financial plan and progress towards closing the funding gap.</p>	<p>Historically the Council have performed well financially. In 2018/19 the Council delivered a £0.019m surplus against its revenue budget. This is in line with budget monitoring throughout the period.</p> <p>The Council started 2018/19 with a £2.7m general fund balance and ended the year with £2.5m.</p> <p>Within the Council's 2018/19 budget there were £0.288m of savings. Of these savings £0.148m have been delivered. The impact of the undelivered element was offset by prudent forecasting of Business Rates.</p> <p>The Council have a significant savings target (circa £1.4m), over the medium term. Work is ongoing to identify savings/income generation schemes to close this gap. This is being tackled through workshops at Group Manager level.</p> <p>Our work found that the processes for monitoring this budget gap have improved in 2018/19. With the finance team maintaining a live MTFP which is updated in real time, but maintains the historic trail to financial reporting.</p> <p>The internal monitoring of schemes that have been identified to close this gap has also improved. Each scheme is clearly identified and whether this is recurrent or non recurrent. Importantly we found that this clearly linked through to budget monitoring and reporting throughout the financial year.</p> <p>The Council have a number of initiatives in play to increase revenues of which 3 Rivers Developments Limited will play a key role.</p>	<p><b>Auditor view</b></p> <p>Despite the challenges faced by the Council there are adequate arrangements in place to achieve financial resilience.</p> <p>Our work found that arrangements have been improved in relation to the medium term financial plan being a living evolving document, that can be clearly traced to ongoing financial reporting.</p>

**Key findings (continued)**

Significant risk	Findings	Conclusion
<p><b>2 Housing Company arrangements</b></p> <p>During 2017/18 the Council set up 3 Rivers Developments Limited. This was incorporated at Companies House on 28 April 2017. This represents a new, innovative way to deliver services.</p> <p>In response to this risk we have reviewed the Council's arrangements for setting up, monitoring and reporting the performance. We have also reviewed the governance arrangements in place.</p>	<p>There is increased scrutiny of commercial arrangements from external bodies such as the National Audit Office that have flagged the importance of council's ensuring that investment decisions are properly risk assessed, that there is adequate due diligence and that appropriate advice is taken on these arrangements.</p> <p>Members need to be clearly sighted on these matters and understand the exposure this is placing on the Council to inform their decision making.</p> <p>3 Rivers Developments Limited continues to evolve and forms an important and integral part of the Council's Strategic Vision. Moving into its second year of operation, the company has delivered some positive outcomes with the completion of a number of units.</p> <p>As part of the 2017/18 audit we raised two recommendations:</p> <ol style="list-style-type: none"> <li>1. The Council should take appropriate advice when assessing funding decisions and whether loans can be funded from capital resource, and</li> <li>2. The Council should review governance and monitoring arrangements to ensure these remain appropriate and on an arms length basis.</li> </ol> <p>It is clear that the Council has made some progress against each of these recommendations, however, these will need to be continually reconsidered as the company continues to grow and evolve.</p> <p>The Company is currently being funded from internal revenue resources and therefore has not had the need to confirm its accounting treatment of external borrowing. Our previous recommendation in this area therefore remains extant. This is detailed in appendix B.</p> <p>During the year the Council commissioned Internal Audit to complete a review of the governance arrangements in place. The work was carried out in December 2018. This review identified a number of issues that form part of the Head of Internal Audit's opinion and are included in the Council's own Annual Governance statement.</p> <p>The key messages from this review were:</p> <ul style="list-style-type: none"> <li>• potential reputational damage from the failure of the company was not included on the risk register,</li> <li>• governance arrangements are not keeping pace with developments,</li> <li>• concerns around conflicts of interest,</li> <li>• Members concerned about over exposure, and the</li> <li>• need to strike a balance between commercial sensitivity and transparency.</li> </ul>	<p><b>Auditor view</b></p> <p>Following our work in this area, in assessing the adequacy of the arrangements in place to 31 March 2019 we have concluded that there are weaknesses in the Council's arrangements for:</p> <ul style="list-style-type: none"> <li>• understanding and using appropriate and reliable financial and performance information to support informed decision making and performance management including where relevant, business cases supporting significant investment decisions,</li> <li>• Acting in the public interest, through demonstrating and applying the principles and values of sound governance, and</li> <li>• Managing risks effectively and maintaining a sound system of internal control.</li> </ul> <p>We acknowledge that since 31 March 2019 there have been, and planned to be developments as the company and the arrangements continue to develop.</p> <p>We have made recommendations for the Council's consideration which we will follow up as a matter of course.</p> <p>We have not stated in our action plan those already raised by the Council's Internal Auditors.</p> <p><b>Management response</b></p> <ul style="list-style-type: none"> <li>• Agreed – We are working in consultation with professional advisors and other authorities with property companies in order to enhance future reporting.</li> </ul>

**Key findings (continued)**

Significant risk	Findings	Conclusion
	<p>Internal Audit have made a number of recommendations as part of their report. We have discussed with management their responses to these recommendations.</p> <p>The Council has put in place mitigations to reduce the risks around conflicts of interest. This is in particular reference to the Council's S151 officer on the board of 3 Rivers Developments Ltd. Whilst it is considered appropriate to have Council representation on the company board to enable it to influence the activity of the company, it is important that the company board is allowed to deliver the strategic and operational plans of the company without excessive interference from the Council. It is equally important that appropriate governance structures are established to safeguard the Council from excessive risk taking or poor performance and that appropriate governance arrangements are in place to allow the Council to hold the company to account where financial and performance targets are not achieved by the company. We recommend that the Council formally considers the adequacy of the current mitigations to determine whether additional governance arrangements need to be put in place to address this risk.</p> <p>The Council now have in place loan agreements for all lending and these are supported by a cashflow forecast. The corporate risks were added to the risk register in June 2019. The Council also plan to increase governance and control through the establishment of an officer programme board, with its purpose to review company performance between formal reporting.</p> <p>Further to this we have carried out work looking specifically at the arrangements that were in place during 2018/19 for reporting and monitoring the performance of the company. As part of this work we also reviewed the links between 3 Rivers Developments Limited's business plan and the Council's capital programme and treasury management strategy to ensure that funding plans were affordable and that the Council were clearly informed about the company's future financing requirements.</p> <p>This work identified the following findings:</p> <ul style="list-style-type: none"> <li>• The Governance arrangements continue to evolve,</li> <li>• The processes around borrowing and cashflow were unclear, however, processes have now been put in place to address this,</li> </ul>	

**Key findings (continued)**

Significant risk	Findings	Conclusion
	<ul style="list-style-type: none"><li data-bbox="472 275 1398 471">• The business plan approved by Cabinet in March 2019 contained inaccuracy and was not transparent in the potential £109m funding requirement of the company and the levels of financing support that will be required from the Council to support these plans. In particular there needs to be more clarity on the projected operating surplus of the company over the life of the business plan and the projected return on investments at scheme level. This will in turn determine any potential future funding requirements from the Council.</li><li data-bbox="472 485 1398 535">• The first performance report was taken to the January 2019 cabinet, it was not clear from review of this document how this linked to the business plan, and</li><li data-bbox="472 549 1398 635">• Greater clarity is needed on the Council's future borrowing requirement. Our work found there was no clear link between the 3 Rivers Limited business plan and the Council's Capital Programme and crucially the Treasury Management Strategy.</li></ul>	

# 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

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we 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 December 2017 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

Details of fees charged are detailed in Appendix D

## 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, as well as the following threats to our independence and safeguards that have been applied to mitigate these threats.

	Fees £	Threats identified	Safeguards
<b>Audit related</b>			
Certification of Housing capital receipts grant	1,500	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 £1,500 in comparison to the total fee for the audit of £36,729 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.
Housing Benefit Certification	14,685	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 £14,685 in comparison to the total fee for the audit of £36,729 and in particular is not significant 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.
Homes and Communities Agency certification	2,000	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 £2,000 in comparison to the total fee for the audit of £36,729 and in particular is not significant 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.
<b>Total</b>	<b>18,185</b>		




These services are consistent with the Council's policy on the allotment of non-audit work to your auditors. None of the services provided are subject to contingent fees.

# Action plan

We have identified 6 recommendations 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 recommendations during the course of the 2019/20 audit. The matters reported here are limited to those 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
	<ul style="list-style-type: none"> <li>Our testing of expenditure identified income items that had been routinely coded to expenditure. Whilst we were able to demonstrate that there is no significant impact there is a risk that income and expenditure could be understated.</li> </ul>	<ul style="list-style-type: none"> <li>We recommend that the Council review procedures for coding income to ensure that income items are coded and classified correctly.</li> </ul> <p><b>Management response</b> Agreed – Further checks have already been put in place and was not a significant area of risk</p>
	<ul style="list-style-type: none"> <li>The Group continues to evolve and grow. As transactions become more complex there is a need to ensure consolidation working papers clearly show the consolidation adjustments. Without this clarity there is a risk that consolidation adjustments are not processed.</li> </ul>	<ul style="list-style-type: none"> <li>We recommend that the Council adapt one working paper that details all Group consolidation adjustments.</li> </ul> <p><b>Management response</b> Agreed.</p>
	<ul style="list-style-type: none"> <li>There are no clear links between the 3 Rivers Developments Limited Business Plan and the Council's own Capital Programme and Treasury Management Strategy.</li> </ul>	<ul style="list-style-type: none"> <li>The Council should ensure that the Treasury Management Strategy fully reflects the 3 Rivers Developments Limited Business Plan (revised) and where possible there are clear links to the Capital Programme.</li> </ul> <p><b>Management response</b> Agreed – this will be addressed at the next 6 monthly Treasury Management Strategy review.</p>
	<ul style="list-style-type: none"> <li>The 3 Rivers Developments Limited Business Plan contains inaccuracies and is not transparent.</li> </ul>	<ul style="list-style-type: none"> <li>We recommend that the Business plan is revisited to ensure accuracy and transparency. We further recommend that all performance reports taken to Cabinet should clearly link back to the approved business plan and should be on a scheme by scheme basis.</li> </ul> <p><b>Management response</b> Agreed – the business plan will be updated in line with the annual timetable and there will be clear links as recommended.</p>

#### Controls

-  High – Significant effect on control system
-  Medium – Effect on control system
-  Low – Best practice

# Action plan (continued)

Assessment	Issue and risk	Recommendations
●	<p>The Council has put in place mitigations to reduce the risks around conflicts of interest. This is with particular reference to the Council's S151 officer on the board of 3 Rivers Developments Limited. Whilst it is considered appropriate to have Council representation on the company board to enable it to influence the activity of the company, it is important that the company board is allowed to deliver the strategic and operational plans of the company without excessive interference from the council. It is equally important that appropriate governance structures are established to safeguard the Council from excessive risk taking or poor performance and that appropriate governance arrangements are in place to allow the Council to hold the company to account where financial and performance targets are not achieved by the company.</p>	<p>We recommend that the Council formally considers the adequacy of the current mitigations to determine whether additional governance arrangements need to be put in place to address this risk.</p> <p><b>Management response</b></p> <p>Agreed – We will review on an ongoing basis. We have already identified the need for an officer programme board and its inaugural meeting is booked for 7 August 2019.</p>
●	<p>The Council have started reporting to Cabinet the 3 Rivers Developments Limited's performance. The first performance report was taken to the January 2019 cabinet. From reviewing this report it was not clear how this report linked to the original business plan, and what the expected milestones were and how the company is performing against these.</p>	<p>We recommend that future reports should link clearly back to approved schemes as set out in the 3 Rivers Developments Limited business plan and should contain an update against expected milestones.</p> <p><b>Management response</b></p> <p>Significant improvements have been implemented and future reports will cover all of these suggestions/comments.</p>

## Controls

- High – Significant effect on control system
- Medium – Effect on control system
- Low – Best practice



# Follow up of prior year recommendations

We identified the following issues in the audit of Mid Devon District Council's 2017/18 financial statements, which resulted in 6 recommendations being reported in our 2017/18 Audit Findings report.

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
✓	<p>The Council's fixed asset register (FAR) is extremely complicated which contributed towards an error identified in the calculation of depreciation. The FAR produces large figures feeding into the financial statements.</p> <p>We recommended that the Council review the Fixed Asset Register to ensure it produces accurate figures for inclusion in the financial statements.</p>	<ul style="list-style-type: none"> <li>• Whilst the Council has not replaced the FAR they have undertaken a detailed review to ensure the formulas are pulling through the correct data. The Council have also improved segregation of duties in this area. Our work on Property, Plant and Equipment in 2018/19 has not identified any issues of inaccurate data.</li> </ul>
✓	<p>In our testing of creditors we identified one instance of an accrual which was found to be invalid. We have assessed the error and consider the error to be significantly trivial however we noted the error arose due to an internal control failure within the process of recording accruals. Management stated the process of an order becoming an accrual is that the order sits on the system as a commitment up to the point at which the goods are received at which the point the order becomes an accrual until the invoice is paid. Management will review purchase orders which are no longer valid and will delete them from the listing however we identified the control did not pick up this item and it was incorrectly accrued for.</p> <p>We recommended management review the controls put in place to identify invalid purchases orders.</p>	<ul style="list-style-type: none"> <li>• The Council have addressed this issue and no similar issues were found in our 2018/19 testing.</li> </ul>
✓	<p>Currently the Council does not monitor its savings programme on a scheme by scheme basis. There is a risk that there could be a perceived lack of transparency. Clearly identifying savings schemes allows each scheme to be monitored but also to ensure that there is no adverse impact on services.</p> <p>We recommended that the Council set out detailed savings plans and monitor progress against each of these.</p>	<ul style="list-style-type: none"> <li>• The Council has improved the transparency of how the budget gap is both monitored and reported.</li> </ul>

## Assessment

- ✓ Action completed
- X Not yet addressed

## Follow up of prior year recommendations (continued)

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
N/A	<p>The Council plan to fund 3 Rivers Developments Ltd through the use of loan capital.</p> <p>We recommended that the Council should review funding plans to ensure the loan can be funded from capital resources. Where applicable the Council should obtain appropriate technical and accounting advice.</p>	<ul style="list-style-type: none"> <li>• There has not been a need to date to borrow to fund the Company. This requirement has been met through the Council's internal revenue resources.</li> <li>• We will continue to monitor this position as future borrowing requirements are confirmed.</li> </ul>
✓	<p>The Council's 3 Rivers Developments Ltd has been set up during the year. With all new companies arrangements will change over time as the company grows and develops.</p> <p>We recommended that the Council should review governance and monitoring arrangements to ensure that these remain appropriate and on an arms length basis.</p>	<ul style="list-style-type: none"> <li>• The Council have commissioned a detailed review by Internal Audit and are striving to ensure these arrangements remain appropriate.</li> </ul>
✓	<p>The lease with Premier Inn allows the hotel to built into 82 car park spaces in the multi story carpark adjacent to the Phoenix House. Management are aware that this will impair the value of the asset and this will need to be considered in 2018/19.</p> <p>We recommended that management should continue to monitor the operational performance of the car park and consider the impact of changes in capacity as part of their ongoing impairment reviews.</p>	<ul style="list-style-type: none"> <li>• Impairment was considered as part of the 2018/19 valuation process.</li> <li>• We reviewed the subsequent accounting treatment and have nothing to report to Members.</li> </ul>

### Assessment

- ✓ Action completed
- X Not yet addressed

# 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.

## Impact of adjusted misstatements

All adjusted misstatements are set out in detail below along with the impact on the key statements and the reported net expenditure for the year ending 31 March 2019.

Detail	Comprehensive Income and Expenditure Statement £'000	Statement of Financial Position £' 000	Impact on total net expenditure £'000
The financial Instruments disclosure note was understated by £3.786m in relation to transactions with 3 Rivers Developments Limited.	N/A	N/A	<ul style="list-style-type: none"> <li>No impact as financial instruments disclosure only.</li> </ul>

## 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.

Disclosure omission	Detail	Auditor recommendations	Adjusted?
<b>Group disclosures</b>	We identified a number of disclosure points in this area as part of our work. These included adding an additional note to explain work in progress and group accounting policies.	<ul style="list-style-type: none"> <li>None</li> </ul>	✓
<b>Officer Emoluments</b>	We identified bandings that were omitted from the draft statements. Although these were zero entries the note appeared incomplete.	<ul style="list-style-type: none"> <li>None</li> </ul>	✓
<b>Financial Statements – Various</b>	During the course of the audit a number of small disclosure amendments were made to the financial statements. These have not been reported separately due to their insignificant nature.	<ul style="list-style-type: none"> <li>None</li> </ul>	✓

# Audit Adjustments

## Impact of unadjusted misstatements

The table below provides details of adjustments identified during the 2018/19 audit which have not been made within the final set of financial statements. The Audit Committee is required to approve management's proposed treatment of all items recorded within the table below:

Detail	Reason for not adjusting
<p><b>1 Potential impact of the McCloud judgement</b></p> <p>The legal ruling around age discrimination (McCloud - Court of Appeal) has implications for pension schemes where transitional arrangements on changing benefits have been implemented.</p> <p>Discussion is ongoing in the sector regarding the potential impact of the ruling on the financial statements of Local Government bodies.</p> <p>The Council has requested an estimate from its actuary of the potential impact of the McCloud ruling. The actuary's estimate was of a possible increase in pension liabilities of £945k, and an increase in service costs for the 2019/20 year of £103k.</p> <p>We have satisfied ourselves that there is not a risk of material error as a result of this issue. We also acknowledge the significant uncertainties relating to the estimation of the impact on the Council's liability.</p>	<p>The figures provided by the actuary are an estimate, and not a formal actuarial valuation. Although we are of the view that there is sufficient evidence to indicate that a liability is probable, we are satisfied that the differences are not likely to be material. This issue will be considered as part of the next actuarial valuation exercise in 2019/20.</p>

# Fees

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

## Audit Fees

	Proposed fee	Final fee
Council Audit	36,729	36,729
<b>Total audit fees</b>	<b>£36,729</b>	<b>£36,729</b>

## Non Audit Fees

Fees for other services	Fees £
<b>Audit related services:</b>	
• Certification of Housing Capital Receipts	1,500
• Housing Benefit Certification	14,685
• Homes and Communities Agency certification (17-18)	2,000
	<b>£18,185</b>



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