

The Annual Audit Letter for Mid Devon District Council

Year ended 31 March 2019

30 August 2019



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Executive Summary

Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Mid Devon District Council (the Council) and its subsidiaries (the group) for the year ended 31 March 2019.

This Letter is intended to provide a commentary on the results of our work to the Council and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Council's Audit Committee as those charged with governance in our Audit Findings Report on 15 July 2019.

Our work

Respective responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council and group's financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council and group's financial statements, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

Materiality	We determined materiality for the audit of the Council's financial statements to be £1,006,000, which is 2% of the Council's gross revenue expenditure.
Financial Statements opinion	We gave an unqualified opinion on the Council's financial statements on 25 July 2019.
Whole of Government Accounts (WGA)	We completed work on the Council's consolidation return following guidance issued by the NAO. The Council was below the threshold for full audit procedures and was limited to preparing an assurance return to the NAO to support its group procedures.
Use of statutory powers	We did not identify any matters which required us to exercise our additional statutory powers.

Executive Summary

Value for Money arrangements	<p>We were satisfied that the Council put in place proper arrangements to ensure 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 affected the following VFM criteria:</p> <ul style="list-style-type: none">• Acting in the public interest, through demonstrating and applying the principles and values of sound governance,• 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• Managing risks effectively and maintaining a sound system of internal control. <p>We therefore qualified our value for money conclusion in our audit report to the Council on 25 July 2019.</p>
Certification of Grants	<p>We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. Our work on this claim is not yet complete and will be finalised by 30 November 2019. We will report the results of this work to the Audit Committee separately.</p>
Certificate	<p>We certified that we have completed the audit of the financial statements of Mid Devon District Council in accordance with the requirements of the Code of Audit Practice on 25 July 2019.</p>

Working with the Council

During the year we have delivered a number of successful outcomes with you:

- An efficient audit – we delivered an efficient audit with you in June and July. We worked closely with officers to ensure the challenging audit timetable was met.
- Understanding your business – through the value for money conclusion we provided you with assurance on your effectiveness. We have made recommendations for improving the arrangements around 3 Rivers Development Limited.

- Sharing our insight – we provided regular audit committee updates covering best practice. We also shared our thought leadership reports.
- Providing training – officers are attending our Housing Benefit workshop in September 2019.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's staff.

Grant Thornton UK LLP
August 2019

Audit of the Financial Statements

Our audit approach

Materiality

In our audit of the Council and Group financial statements, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for the audit of the group financial statements to be £1,006,000, which is 2% of the Council and Group's gross revenue expenditure. We used this benchmark as, in our view, users of the Group and Council's financial statements are most interested in where the Group and Council has spent its revenue in the year.

We also set a lower level of specific materiality for senior officer remuneration of £5,000. This was to ensure bandings were accurately disclosed.

We set a triviality threshold of £50,300, above which we reported errors to the Audit Committee in our Audit Findings Report.

The scope of our audit

Our audit involves obtaining sufficient evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error. This includes assessing whether:

- the accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the financial statements and the narrative report, annual governance statement published alongside the financial statements to check it is consistent with our understanding of the Council and with the financial statements included in the Annual Report on which we gave our opinion.

We carry out our audit in accordance with ISAs (UK) and the NAO Code of Audit Practice. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Council and group's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the Financial Statements

Significant Audit Risks

These are the significant risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Improper revenue recognition</p> <p>Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue.</p> <p>This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.</p>	<p>We considered the risk factors set out in ISA240 and the nature of the revenue streams at the Council, and we determined that the risk of fraud arising from revenue recognition can be rebutted, because:</p> <ul style="list-style-type: none">• there is little incentive to manipulate revenue recognition;• opportunities to manipulate revenue recognition are very limited; and• the culture and ethical frameworks of local authorities, including Mid Devon District Council, mean that all forms of fraud are seen as unacceptable <p>Therefore we concluded that we do not consider this to be a significant risk for Mid Devon District Council.</p>	
<p>Management override of controls</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>We completed the following work in relation to this risk:</p> <ul style="list-style-type: none">• reviewed accounting estimates, judgements and decisions made by management,• tested journal entries,• reviewed unusual significant transactions, and• reviewed significant related party transactions outside the normal course of business.	<p>Our audit work did not identified any issues in respect of management over-ride of controls.</p>

Audit of the Financial Statements

Significant Audit Risks - continued

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Valuation of land and buildings</p> <p>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.</p> <p>Management have engaged the services of a valuer to estimate the current value as at 31 March 2019.</p> <p>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.</p>	<p>We undertook the following work in relation to this risk:</p> <ul style="list-style-type: none">• Reviewed management's processes and assumptions for the calculation of the estimate.• Reviewed the competence, expertise and objectivity of any management experts used.• Reviewed the instructions issued to valuation experts and the scope of their work.• Discussed with the Council's valuer the basis on which the valuation was carried out, and challenged the key assumptions.• Reviewed and challenged the information used by the valuer to ensure it was robust and consistent with our understanding.• Tested revaluations made during the year to ensure they were input correctly into the Council's asset register• Evaluated 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. <p>Our work did not identify any issues in relation to the valuation of land and buildings.</p>	<p>Our audit work did not identify any issues in respect of the Valuation of Land and Buildings.</p>

Audit of the Financial Statements

Significant Audit Risks - continued

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Valuation of pension fund net liability</p> <p>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.</p> <p>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.</p> <p>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.</p>	<p>We undertook the following work in relation to this risk:</p> <ul style="list-style-type: none"> 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. Reviewed the competence, expertise and objectivity of the actuary who carried out the Council's pension fund valuation. Gained 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. Reviewed the consistency of the pension fund net liability disclosures in notes to the financial statements with the actuarial report from your actuary. 	<p>Although our audit work did not identify any issues in respect of this risk, we discussed the potential impact of the McCloud ruling on the financial statements of Local Government bodies.</p> <p>The Council 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 was that the impact of the ruling was not material for Mid Devon District Council, and will be considered for future years' actuarial valuations.</p> <p>We reported this in our Audit Findings Report as an unadjusted misstatement.</p>

Audit of the Financial Statements

Audit opinion

We gave an unqualified opinion on the Council and Group's financial statements on 25 July 2019.

Preparation of the financial statements

The Council presented us with draft financial statements in accordance with the national deadline, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit.

Issues arising from the audit of the financial statements

We reported the key issues from our audit to the Council's Audit Committee on 15 July 2019.

Annual Governance Statement and Narrative Report

We are required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website in the Statement of Accounts in line with the national deadlines.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Council and with our knowledge of the Council.

Whole of Government Accounts (WGA)

We carried out work on the Council's Data Collection Tool in line with instructions provided by the NAO . We issued an assurance statement which confirmed the Council was below the audit threshold.

Certificate of closure of the audit

We certified that we have completed the audit of the financial statements of Mid Devon District Council in accordance with the requirements of the Code of Audit Practice on 25 July 2019.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 which specified the 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.

Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the risks where we concentrated our work.

The risks we identified and the work we performed are set out overleaf.

As part of our Audit Findings report agreed with the Council in July 2019, we agreed recommendations to address our findings.

Overall Value for Money conclusion

We are satisfied that, in all significant respects, except for the matter we identified overleaf in respect of 3 Rivers Development Ltd, the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2019.

Value for Money conclusion

Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Financial resilience</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>In response to this risk we 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 through out 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>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>

Value for Money conclusion

Value for Money Risks (continued)

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Housing Company arrangements</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"> 1. The Council should take appropriate advice when assessing funding decisions and whether loans can be funded from capital resource, and 2. The Council should review governance and monitoring arrangements to ensure these remain appropriate and on an arms length basis. <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.</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>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"> • 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, • Acting in the public interest, through demonstrating and applying the principles and values of sound governance, and • Managing risks effectively and maintaining a sound system of internal control. <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>

Value for Money conclusion

Value for Money Risks (continued)

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
	<p>The key messages from this review were:</p> <ul style="list-style-type: none">• potential reputational damage from the failure of the company was not included on the risk register,• governance arrangements are not keeping pace with developments,• concerns around conflicts of interest,• Members concerned about over exposure, and the• need to strike a balance between commercial sensitivity and transparency. <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 have recommended 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>	

Value for Money conclusion

Value for Money Risks (continued)

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
	<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">• The Governance arrangements continue to evolve,• The processes around borrowing and cashflow were unclear, however, processes have now been put in place to address this,• 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.• 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• 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.	

A. Reports issued and fees

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

Reports issued

Report	Date issued
Audit Plan	22 January 2019
Audit Findings Report	15 July 2019
Annual Audit Letter	30 August 2019

Fees

	Planned £	Actual fees £	2017/18 fees £
Statutory audit	36,729	41,229	47,700
Total fees	36,729	41,229	47,700

Audit fee variation

As outlined in our audit plan, the 2018-19 scale fee published by PSAA of £36,729 assumes that the scope of the audit does not significantly change. There are a number of areas where the scope of the audit has changed, which has led to additional work. Since reporting our Audit Findings Report to the Council's audit committee on 15 July 2019, we have reviewed the level of additional work required and additional fees necessary to reflect these additional costs of delivery. These are set out in the following table.

Area	Reason	Fee proposed
Assessing the impact of the McCloud ruling	The Government's transitional arrangements for pensions were ruled discriminatory by the Court of Appeal last December. The Supreme Court refused the Government's application for permission to appeal this ruling. As part of our audit we have reviewed the revised actuarial assessment of the impact on the financial statements along with any audit reporting requirements.	£1,500
Pensions – IAS 19	The Financial Reporting Council has highlighted that the quality of work by audit firms in respect of IAS 19 needs to improve across local government audits. Accordingly, we have increased the level of scope and coverage in respect of IAS 19 this year to reflect this.	£1,500
PPE Valuation – work of experts	As above, the Financial Reporting Council has highlighted that auditors need to improve the quality of work on PPE valuations across the sector. We have increased the volume and scope of our audit work to reflect this.	£1,500
Total		£4,500

Fee variations are subject to PSAA approval.

A. Reports issued and fees continued

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

Fees for non-audit services

Service	Fees £
Audit related services	
• Certification of Housing Capital Receipts	1,500
• Housing Benefit Certification	14,685
• Homes and Communities Agency certification (17-18)	2,000
Non-Audit related services	
- None	Nil
Total	18,185

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 table above summarises all non-audit services which were identified.
- We have considered whether non-audit services might be perceived as a threat to our independence as the Council's auditor and have ensured that appropriate safeguards are put in place.

The above non-audit services are consistent with the Council's policy on the allotment of non-audit work to your auditor.

