



The Annual Audit Letter for South Somerset District Council

Year ended 31 March 2019

29 August 2019



Contents



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Section

1. Executive Summary
2. Audit of the Financial Statements
3. Value for Money conclusion

Page

- 3
5
9

Appendices

- A Reports issued and fees

Executive Summary

Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at South Somerset District Council (the Council) 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 25 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 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 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 £1,530,000, 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 31 July 2019. |
| Whole of Government Accounts (WGA) | We completed work on the Council's consolidation return following guidance issued by the NAO. |
| 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 | We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Council on 25 July 2019. |
| Certification of Grants | 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 28 November 2019. We will report the results of this work to the Audit Committee separately. |
| Certificate | We certified that we have completed the audit of the financial statements of South Somerset District Council in accordance with the requirements of the Code of Audit Practice on 31 July 2019. |

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 July, delivering the financial statements before the deadline
- Understanding your operational health – through the value for money conclusion we provided you with assurance on your operational effectiveness
- Sharing our insight – we provided regular audit committee updates covering best practice. We also shared our thought leadership reports
- Financial statements workshop - we invited members of your finance team to our workshop on current developments that impacted the 2018-19 financial statements
- Supporting development – We provided training for the Audit Committee on the role of External Audit

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's 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 Council's financial statements to be £1,530,000, which is 2% of the Council's gross revenue expenditure. We used this benchmark as, in our view, users of the Council's financial statements are most interested in where the Council has spent its revenue in the year.

We also set a lower level of specific materiality for senior officer remuneration of £20,000 due to its sensitive nature.

We set a lower threshold of £76,500, 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, the narrative report and annual governance statement 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'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>Management override of controls</p> <p>Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management override of controls is present in all entities. The Council faces external scrutiny of its spending, and this could potentially place management under undue pressure in terms of how they report performance.</p> <p>Management over-ride of controls is a risk requiring special audit consideration.</p> | <p>We have performed the following work in respect of this risk:</p> <ul style="list-style-type: none"> gained an understanding of the accounting estimates, judgements applied and decisions made by management and considered their reasonableness; obtained a full listing of journal entries and identified and subsequently tested any unusual journal entries for appropriateness; and evaluated the rationale for any changes in accounting policies and any significant unusual transactions or estimates. | <p>Our audit work has not identified any issues in respect of management override of controls.</p> |
| <p>Valuation of property, plant and equipment</p> <p>The Council revalues its larger assets on an annual basis and the remaining assets on a rolling basis over a five year period to ensure that carrying value is not materially different from fair value. This represents a significant estimate by management in the financial statements.</p> <p>We identified the valuation of land and buildings revaluations and impairments as a risk requiring special audit consideration</p> | <p>We have performed the following work in respect of this risk:</p> <ul style="list-style-type: none"> evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to the valuation experts and the scope of their work; evaluated the competence, capabilities and objectivity of the valuation expert; written to the valuer to confirm the basis on which the valuations were carried out; challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding; and tested, on a sample basis, revaluations made during the year to ensure they have been input correctly into the Authority's asset register. <p>We identified that all land and buildings are classified as specialist assets and have been valued using the depreciated replacement cost (DRC) method.</p> | <p>Our audit work has not identified any issues in respect of valuation of land and buildings.</p> |

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>Valuation of pension fund net liability</p> <p>The Council's pension fund asset and liability as reflected in its balance sheet represent a significant estimate in the financial statements.</p> <p>We identified the valuation of the pension fund net liability as a risk requiring special audit consideration.</p> | <p>We have performed the following work in respect of this risk:</p> <ul style="list-style-type: none"> • updated our understanding of the processes and controls put in place by management to ensure that the Authority's pension fund net liability is not materially misstated and evaluated the design of the associated controls; • evaluated the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work; • maintained ongoing communication around the impact of the McCloud /Sergeant court judgement on the pension liabilities reported by the Authority to ensure that these are materially stated and in line with proper accounting practices; • assessed the competence, capabilities and objectivity of the actuary who carried out the Authority's pension fund valuation; • assessed the accuracy and completeness of the information provided by the Authority to the actuary to estimate the liability; • tested the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary; and • undertaken procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report. | <p>Our audit work has not identified any issues in respect of valuation of pension fund net liability.</p> <p>The Council requested an estimate from its actuary of the potential impact of the 'McCloud' ruling and GMP equalisation changes. The actuary's estimate was of a possible increase in pension liabilities of £281k. 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> |

Audit of the Financial Statements

Audit opinion

We gave an unqualified opinion on the Council's financial statements on 31 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 25 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 South Somerset District Council in accordance with the requirements of the Code of Audit Practice on 31 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 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>Transformation Programme – Commercialisation Programme</p> <p>The Council is in the process of implementing an ambitious programme to redesign the organisation and methods of service delivery to deliver more customer focussed, lean, efficient services and release recurring significant savings in future years.</p> <p>In order to deliver this transformation, the Council will need to make an upfront investment of some £7.5m to cover the cost of restructuring, including £4.5m of redundancy costs, as well as the cost of new IT infrastructure.</p> <p>The first stage of the transformation programme has now been complete and all service areas have been reviewed and restructured. The Council now needs to ensure that momentum is maintained and that the Commercialisation programme, designed to increase revenue, is properly implemented. Failure to do so could lead to loss of income, missed savings targets and potentially failure by the Council to deliver services to the local population.</p> <p>The successful implementation of the commercialisation strategy represents a significant risk to the Council in terms of:</p> <ul style="list-style-type: none"> • Achievement of revenue targets to fund delivery of services • Robust governance over decisions made, with transparency and clarity for elected members • Close monitoring of costs and revenues generated as a result of decisions made to ensure that the overall financial benefits are realised and that returns are in line with assumptions • Appropriate expertise employed by the Council to deliver the strategy and identify appropriate and relevant opportunities to maximise benefit to the organisation. | <p>We have reviewed the project management arrangements in place at the Council to assess how it is addressing the risks and any mitigating actions it may need to take to deliver the planned outcomes</p> | <p>South Somerset District Council (the Council) is in a position where it needs to save costs and generate additional income over the coming years, if it is to be financial sustainable and be able to meet community needs. To this end an income generation programme was set up with the sole aim of helping the council in becoming financially sustainable.</p> <p>The financial implication for this was the set up of a ringfenced £15m which was 'earmarked', later increased to £75m, to enable the overall capital programme to be set and financed in the most efficient way possible. The expectation is that any investment would generate income well in excess of the costs of borrowing.</p> <p>The commercial strategy was approved by Council in August 2017 which included a new Commercial Strategy for 2017-2021 with the aim to manage assets and investments well with:</p> <ul style="list-style-type: none"> • Clear policies on property asset classification and purpose • Achieving a balanced portfolio with risks effectively managed • A significant investment fund supported by effective governance and appraisal processes • Appetite to support capital investment through borrowing • Invest in operations capacity to deliver the strategy. <p>The commercial strategy is to provide a net increase in income in excess of £2.25m per year by 2020/21, with a stretch target of £3m per year.</p> <p>The Commercial strategy and investments progress report is a regular report to inform members on progress to date and commercial investment activity.</p> <p>As part of the commercial strategy the Council agreed that the normal approval process may compromise the commercial interests of the Council. It was therefore agreed that the investment process would include:</p> <ul style="list-style-type: none"> • All potential investments being required to meet the parameters of the Commercial Strategy agreed by the Council including rate of return and the creation of a balanced portfolio • All potential investments being required to go through a rigorous assessment and due diligence process including assessment of risk and mitigation • That investments would be assessed by a newly established Investments Assessment Group (IAG) comprising the Portfolio Holder, Commercial Director, S151 Officer, Monitoring Officer and Commercial Property, Land and Development Manager and there is a requirement for a unanimously agreed recommendation from this group on investment proposals |

Value for Money conclusion

Value for Money Risks

| Risks identified in our audit plan | How we responded to the risk | Findings and conclusions |
|--|---|---|
| <p>Transformation Programme – Commercialisation Programme</p> | <p>We have reviewed the project management arrangements in place at the Council to assess how it is addressing the risks and any mitigating actions it may need to take to deliver the planned outcomes</p> | <ul style="list-style-type: none"> That the final decision on investments be delegated to the Chief Executive in consultation with the Leader, up to an agreed limit (with no such proposals being considered unless a unanimous recommendation comes forward from the IAG). <p>As at June 2019 the total amount invested was £36m on four commercial investments which were funded through a combination of reserves and borrowing. At this point the plan was to utilise £18.1m of borrowing towards the funding of these investments with the balance from capital/revenue reserves.</p> <p>Part of the ongoing reporting to members is to identify those assets that the Council could have potentially invested in and chose not to. This is to demonstrate a prudent and regimented approach is being taken to investment decisions. The IAG is the main group responsible for this and have set a benchmark of a 7% return on investment for any investment. However, should an investment opportunity not return 7% it is not an automatic decision that the Council will not invest, each individual opportunity is reviewed on its merits before a decision is made.</p> <p>Decisions on whether to invest or dispose of assets is taken by the IAG and the Disposal Assessment Group (DAG). Notes of IAG and DAG are not generally shared with members due to commercial sensitivity but are covered in the recommendations to the CEO and Leader for the formal decision process, considering the overall portfolio position and performance</p> <p>Conclusion</p> <p>The Council has a clear investment strategy in place that is designed to increase revenue and cover the gap within the MTFP with the ultimate aim of making the Council more financially resilient in future years.</p> <p>The decision making process involves a number of members and senior management who have been given delegated decisions making powers by the Council in order to be agile and allow decisions to be made quickly and in line with the market.</p> <p>The Council have chosen to devolve the decision making process and the performance to date, with the clear consideration of the factors that impact on future decisions, demonstrate that the Council have a robust governance process. However, the frequency of reporting at every six months should be kept under review to ensure that is sufficient to enable Members to effectively monitor and challenge decisions in a timely way.</p> <p>We therefore conclude that the Council has appropriate processes in place for achieving value for money.</p> |

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 | 15 January 2019 |
| Audit Findings Report | 16 July 2019 |
| Annual Audit Letter | 30 August 2019 |

Fees

| | Planned £ | Actual fees £ | 2017/18 fees £ |
|-------------------------------------|---------------|------------------|-------------------|
| Statutory audit | 37,943 | 37,943 | 49,276 |
| Housing Benefit Grant Certification | 8,000 | TBC | 9,898 |
| Total fees | 45,943 | 37,943 | 59,174 |

Audit fee variation

As outlined in our audit plan, the 2018-19 scale fee published by PSAA of £37,943 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. 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 | 8,000 |
| - Certification of Housing Benefit (estimate) | |

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

Our commitment to our local government clients

- Senior level investment
- Local presence enhancing our responsiveness, agility and flexibility.
- High quality audit delivery
- Collaborative working across the public sector
- Wider connections across the public sector economy, including with health and other local government bodies
- Investment in Health and Wellbeing, Social Value and the Vibrant Economy
- Sharing of best practice and our thought leadership.
- Invitations to training events locally and regionally – bespoke training for emerging issues
- Further investment in data analytics and informatics to keep our knowledge of the areas up to date and to assist in designing a fully tailored audit approach

Our relationship with our clients – why are we best placed?

- We work closely with our clients to ensure that we understand their financial challenges, performance and future strategy.
- We deliver robust, pragmatic and timely financial statements and Value for Money audits
- We have an open, two way dialogue with clients that support improvements in arrangements and the audit process
- Feedback meetings tell us that our clients are pleased with the service we deliver. We are not complacent and will continue to improve further
- Our locally based, experienced teams have a commitment to both our clients and the wider public sector
- We are a Firm that specialises in Local Government, Health and Social Care, and Cross Sector working, with over 25 Key Audit Partners, the most public sector specialist Engagement Leads of any firm
- We have strong relationships with CIPFA, SOLCAE, the Society of Treasurers, the Association of Directors of Adult Social Care and others.

New opportunities and challenges for your community

The Local Government economy

Local authorities face unprecedented challenges including:

- Financial Sustainability – addressing funding gaps and balancing needs against resources
- Service Sustainability – Adult Social Care funding gaps and pressure on Education, Housing, Transport
- Transformation – new models of delivery, greater emphasis on partnerships, more focus on economic development
- Technology – cyber security and risk management

At a wider level, the political environment remains complex:

- The government continues its negotiation with the EU over Brexit, and future arrangements remain uncertain.
- We will consider your arrangements for managing and reporting your financial resources as part of our work in reaching our Value for Money conclusion.
- We will keep you informed of changes to the financial reporting requirements for 2018/19 through on-going discussions and invitations to our technical update workshops.

Delivering real value through:

- Early advice on technical accounting issues, providing certainty of accounting treatments, future financial planning implications and resulting in draft statements that are 'right first time'
- Knowledge and expertise in all matters local government, including local objections and challenge, where we have an unrivalled depth of expertise.
- Early engagement on issues, especially on ADMs, housing delivery changes, Children services and Adult Social Care restructuring, partnership working with the NHS, inter authority agreements, governance and financial reporting
- Implementation of our recommendations have resulted in demonstrable improvements in your underlying arrangements, for example accounting for unique assets, financial management, reporting and governance, and tax implications for the Cornwall Council companies
- Robust but pragmatic challenge – seeking early liaison on issues, and having the difficult conversations early to ensure a 'no surprises' approach – always doing the right thing
- Providing regional training and networking opportunities for your teams on technical accounting issues and developments and changes to Annual Reporting requirements
- An efficient audit approach, providing tangible benefits, such as releasing finance staff earlier and prompt resolution of issues.

Grant Thornton in Local Government

Our client base and delivery

- We are the largest supplier of external audit services to local government
- We audit over 150 local government clients
- We signed 95% of our local government opinions in 2017/18 by 31 July
- In our latest independent client service review, we consistently score 9/10 or above. Clients value our strong interaction, our local knowledge and wealth of expertise.

Our connections

- We are well connected to MHCLG, the NAO and key local government networks
- We work with CIPFA, Think Tanks and legal firms to develop workshops and good practice
- We have a strong presence across all parts of local government including blue light services
- We provide thought leadership, seminars and training to support our clients and to provide solutions

Our people

- We have over 25 engagement leads accredited by ICAEW, and over 250 public sector specialists
- We provide technical and personal development training
- We employ over 80 Public Sector trainee accountants

Our quality

- Our audit approach complies with the NAO's Code of Audit Practice, and International Standards on Auditing
- We are fully compliant with ethical standards
- Your audit team has passed all quality inspections including QAD and AQR

Our technical support

- We have specialist leads for Public Sector Audit quality and technical
- We provide national technical guidance on emerging auditing, financial reporting and ethical areas
- Specialist audit software is used to deliver maximum efficiencies



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