



2020/21 Audit Findings: Interim Management Response

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Purpose of the Report

1. Audit Committee received an interim Audit Findings Report from Grant Thornton, SSDC's external auditors, at its meeting on 24th March 2022. This report is management's interim response to the issues raised within that report.

Forward Plan

2. This report appeared on the Audit Committee Forward Plan with an anticipated Committee date of 26th May 2022.

Public Interest

3. South Somerset District Council (SSDC) spent £123.1 million in 2020/21 delivering services to its residents (£80.9m revenue expenditure and £42.2m on capital expenditure). This is a significant sum of public money.
4. Financial statements are the main way in which councils account for how they use their resources. Councils must prepare and publish financial statements setting out their financial performance for the year. To do this, they need to maintain proper accounting records and ensure they have effective systems of internal control.
5. Taxpayers, national bodies, and other stakeholders reasonably expect that the external auditor will normally be able to assure that the financial statements have been properly prepared, are free from material error, and that the body has proper arrangements in place to secure value for money.
6. Where the auditors are satisfied that the financial statements present a true and fair view of the council's financial position and that they have been prepared properly in accordance with relevant legislation and codes of practice, they issue an unqualified opinion.
7. Where they are not satisfied, or where they have other matters to which they wish to draw attention, they give a qualified report. Where the auditors consider that a particular matter is sufficiently serious to draw it to public attention more widely, including informing the relevant Secretary of State, they may choose to make a statutory recommendation requiring a public response or issue a Public Interest Report (PIR).
8. SSDC has not yet received a final opinion from the external auditors, Grant Thornton, on the council's 2020/21 Statement of Accounts: Audit Committee should receive this at its July 2022 meeting subject to the final audit work being able to be completed.



9. The auditors' interim Audit Findings Report however, presented to Audit Committee on 24th March 2022, stated: "we have substantially completed our audit of your financial statements and, subject to outstanding queries being resolved, we anticipate issuing an unqualified audit opinion".
10. The auditors' have raised issues about how the council's officers have handled the process of preparing the accounts and their subsequent audit. To put the issues raised by the external auditors in context, they did not advise Audit Committee that at that time, and subject to outstanding issues being concluded satisfactorily, they had any concerns about the possible need for them to issue a qualified opinion nor to write a Public Interest Report.
11. This report is in response to Audit Committee's request that management respond to the issues that the external auditors' did however raise, regarding the process of preparing the 2020/21 statements and their subsequent audit. We acknowledge that improvements need to be made by SSDC to expedite an efficient audit process. The actions we are taking in making the required improvements are highlighted in the report.
12. One of the issues raised by Grant Thornton is the lateness of receiving the draft statement of accounts and the lateness of being able to give an audit opinion. To put this into the overall national context, 85% of English local government and police bodies met the statutory publication date for the draft unaudited statements: SSDC was one of them, but we did subsequently find that we had omitted a new subsidiary, Fareham Energy Reserve Limited, from the draft group accounts and subsequently informed external audit.
13. The majority (91%), including SSDC, missed the statutory deadline of 30 September 2021 for publication of their audited 2020/21 accounts: by the end of December 2021 that figure had fallen to 60%. (Source: Local Government Association: *Update on Local Audit*, 2nd March 2022).
14. As at the end of April 2022, 45%, including SSDC, had still to publish audited financial statements for the 2020/21 financial year (source Director, Grant Thornton, from published data consolidated by Public Sector Audit Appointments (PSAA). It should be noted however that many of the councils that are still outstanding now are upper and unitary tier councils and the issue holding up their final audit largely relates on how infrastructure (highways) assets should be valued. But the underlying point is that SSDC are not unique.

Recommendations

15. That Audit Committee:
 - a) Considers Management's interim response to the issues raised by Grant Thornton in their Initial Audit Findings Reports and the actions management has taken, or are about to implement, to address these issues.
 - b) Notes that a final management response addressing all issues fully will come to Audit Committee at its meeting in July 2022 alongside the external auditors' final Audit Findings Report for 2020/21.



Background

16. Grant Thornton, the council's external auditors, presented an interim Audit Findings Report to Audit Committee at its meeting on 24th March 2022. This was an interim report, as the external audit had not been finalised at that date, nor has it been at the time of writing this report.
17. Whilst the auditors concluded that they anticipated issuing an unqualified opinion, on the assumption that outstanding matters were resolved, they did highlight a number of issues in their report. The issues raised can be grouped under the following key areas:
 - a) Inappropriate challenge and unprofessionalism from a few council officers in response to the auditors' questions.
 - b) Delays in preparing the draft statement of accounts and then undertaking the audit process efficiently.
 - c) Insufficient quality/completeness of working papers and audit responses.
 - d) Management not implementing prior-period audit recommendations.
 - e) Errors in the draft accounts prepared.
 - f) Valuation of Property, Plant and Equipment (PPE) assets including the group assets.
 - g) Whether the MRP (Minimum Revenue Provision) charges in the accounts are sufficient and comply with relevant codes of practice.
 - h) Whether the investigation of a previous Director is appropriately disclosed in the 2020/21 Annual Governance Statement.
18. This report will give an initial response to all of these issues excepting items (e) and (f) above. Errors identified by the external auditors, item (e), are usual at this stage of the audit process and, given this position may change at the end of the audit; we will address that issue in our final management response. Item (f), regarding MRP charges, are still in discussion with the external auditors and therefore we will again address this issue in our final management response.

Management's Initial Response

Inappropriate challenge and unprofessionalism from a few council officers in response to the auditors' questions

19. We agree that this has happened and we acknowledge that this is unacceptable behaviour. The Chief Executive has apologised to Grant Thornton in public (at the last Audit Committee) and privately when she became aware of the issue. Both the Monitoring Officer and the Chief Finance Officer intervened immediately, when the auditor first raised this as an issue, thus enabling the auditors to get the information they needed to undertake the audit.



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20. The key area of the council exhibiting these behaviours was outside of the Finance team. One of the key individuals involved is now no longer employed by the organisation.

21. **Actions/Improvements for 2021/22** :

- We have undertaken end-of-closure briefings for all staff involved in the process across the Council including emphasising the role and importance of the external auditors in the process.
- We are currently finalising a Communications/Engagement Protocol for all staff that are involved in the external audit process and who provide information to the external auditors.

Delays in preparing the statement of accounts and undertaking the audit process efficiently

22. The external auditors highlight the following as being the key causes for the delays experienced and the consequential need to stop and restart the audit process: remote working because of Covid, lack of capacity in SSDC's finance team, conflicting SSDC work priorities, and delays in obtaining information from SSDC internal valuers and SSDC Opium Power Ltd.'s valuers.

General Context

23. External audit firms work to tight and precise deadlines as they have multiple clients often with the same audit deadline. If an agreed deadline is missed, the audit firm will often need to reschedule the restart the audit some months ahead as it will need to move onto other clients in order that they can get the overall yearly audit work delivered.

24. SSDC, in line with most district councils, has a small generalist finance team that undertakes all of the work needed across the financial year: i.e budget preparation, in-year budget monitoring, year-end closure, preparation of the annual Statement of Accounts, and liaison with the external auditors. This contrasts with upper tier councils who have large and specialist finance teams, often including one team primarily focused on producing the Statement of Accounts and undertaking the liaison needed with the external auditors. On top of this, SSDC's finance team deals with ad-hoc queries from management and budget holders, analyses the financial implications of proposals to District Executive and Council, and more recently is engaged in a number of finance sub-work streams in the LGR (Local Government Reorganisation) programme.

25. Ideally, a small generalist finance team therefore needs to be able to undertake the key yearly financial tasks in a logical and mostly progressive order i.e budget setting for new financial year, then closure of last financial year and its audit, followed by in-year budget monitoring before the cycle starts again. Problems and knock-on impacts start to occur and increase as soon as this order of work is compromised and agreed deadlines are missed. This is complicated further when the external auditors' ability to undertake the audit, given the firm's workload with other clients, also has to be taken into account.

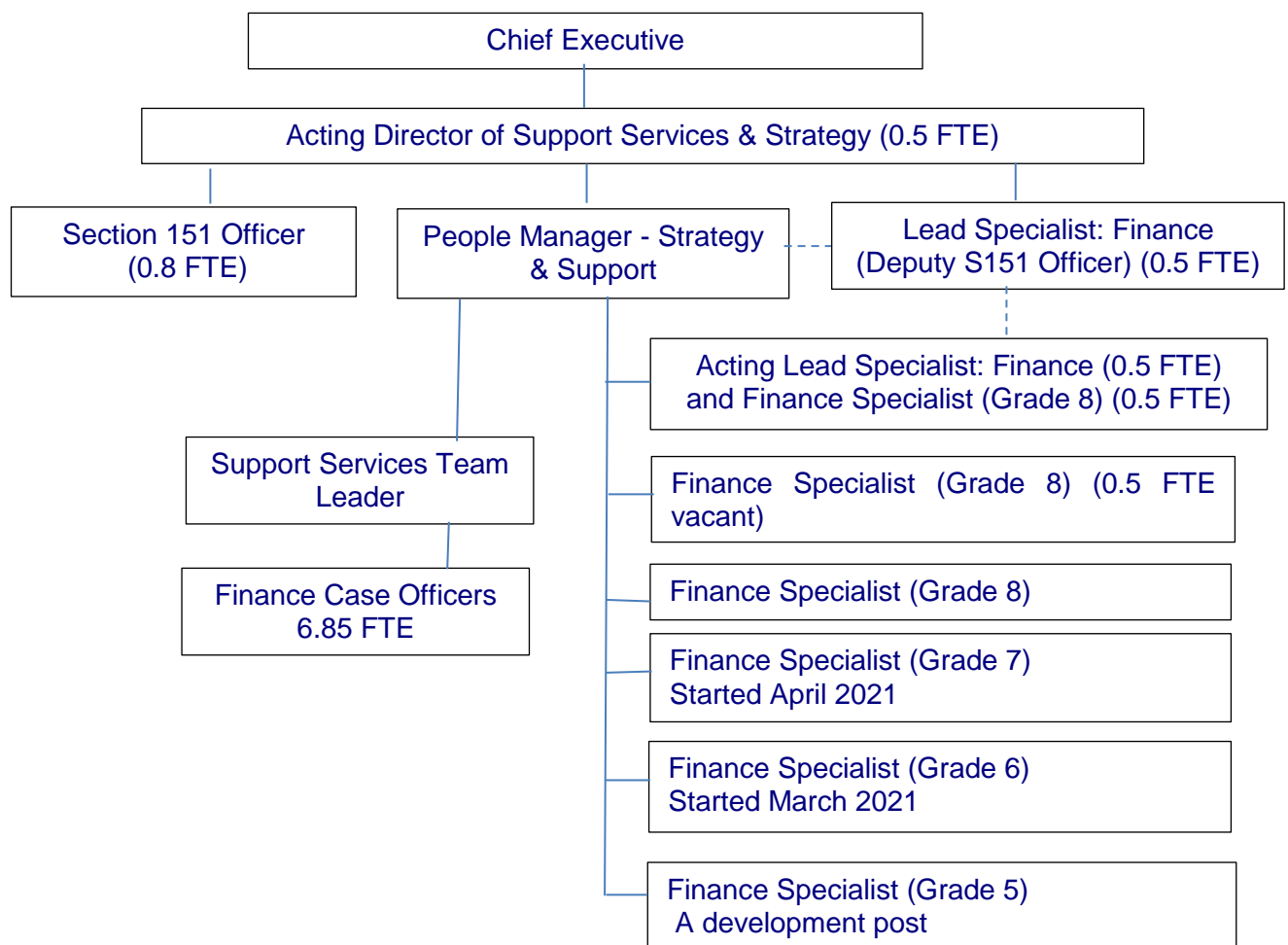
Lack of capacity in the SSDC finance team

26. The previous S151 Officer, along with SLT membership of that time, agreed with Grant Thornton that the latter could start the 2020/21 audit in mid-June 2021 on the basis that SSDC would have prepared the draft statements by the end of May 2021, before the statutory deadline of end of July 2021.



27. That decision at the time was a robust and valid one. The Finance Team was almost fully staffed, relatively experienced, and stable (although it did have two new members, both recruited from other district council finance teams and with relevant experience). In addition, the prior year's deadline agreed with the external auditors had been achieved, and therefore there was no reason known at the time to agree a later deadline with Grant Thornton.
28. Diagram One below shows the finance team capacity as it existed at the time the closedown for 2020/21 started in March /April 2021.

Diagram One: Finance Team capacity and management structure as at start of closure process (March/April 2021)



29. Since then there has been a significant amount of change in the finance team due to resignation/retirement, internal promotions, and new members of staff. The changes up to the end of June 2022 (the deadline agreed with Grant Thornton for producing the draft statement of accounts) comprise:
- The resignation of the S151 Officer and subsequent appointment of an interim post holder from mid-March 2022, initially at 0.7 FTE (Full Time Equivalent), although the hours worked increased during this time-period.
 - The retirement of a very experienced and long-standing team member (Finance Specialist grade 8) in March 2021.



- The internal promotion of the Acting Lead Specialist Finance (grade 8) in May 2021 to the permanent grade 9 role and the Deputy Section 151 Officer designation.
 - The internal promotion of the Lead Specialist Finance (Deputy S151 Officer) (0.5FTE) to the role of Director Strategy and Support on a full time permanent basis which resulted in a further loss of significant experience and capacity in the team.
 - The internal promotion of one of the grade 7 Finance Specialists to a grade 8 role from May 2021 and the unrelated resignation of the other grade 7 postholder in late May 2021. This then created two vacancies at grade 7, which were not filled, following a permanent staff recruitment process, until September 2021 due to the notice period of the individuals appointed.
30. The consequential impact of these changes on the closure process was that some team members had to undertake and lead on complex areas of the accounts with no previous experience in that area (in particular the Collection Fund, capital accounting, and day-to-day coordination of the closure process in general).
31. The then new Section 151 Officer, over this period, was primarily engaged in undertaking a deep dive financial review of the Regeneration Programme, along with the newly appointed Director for Regeneration and Place. Given the scale, in terms of financial impact and risk of these budgets, and the importance of the work needed in this area to deliver corporate priorities, coupled with the fact that this work could not practically be continued personally by the S151 Officer given her other responsibilities, approval was sought and given by Senior Leadership Team to recruit to an interim Regeneration Accountant role. This appointment commenced in July 2021.
32. In In hindsight, agreeing to an earlier than statutorily required date) for the production of the draft statements was always going to be a challenge, given the significant changes that occurred to the finance team after that decision was taken. Grant Thornton had no option but to move onto other clients' work in mid July 2021. It is important however to note that the statutory deadline for the production and publication of draft accounts was achieved at the end of July.

Conflicting priorities

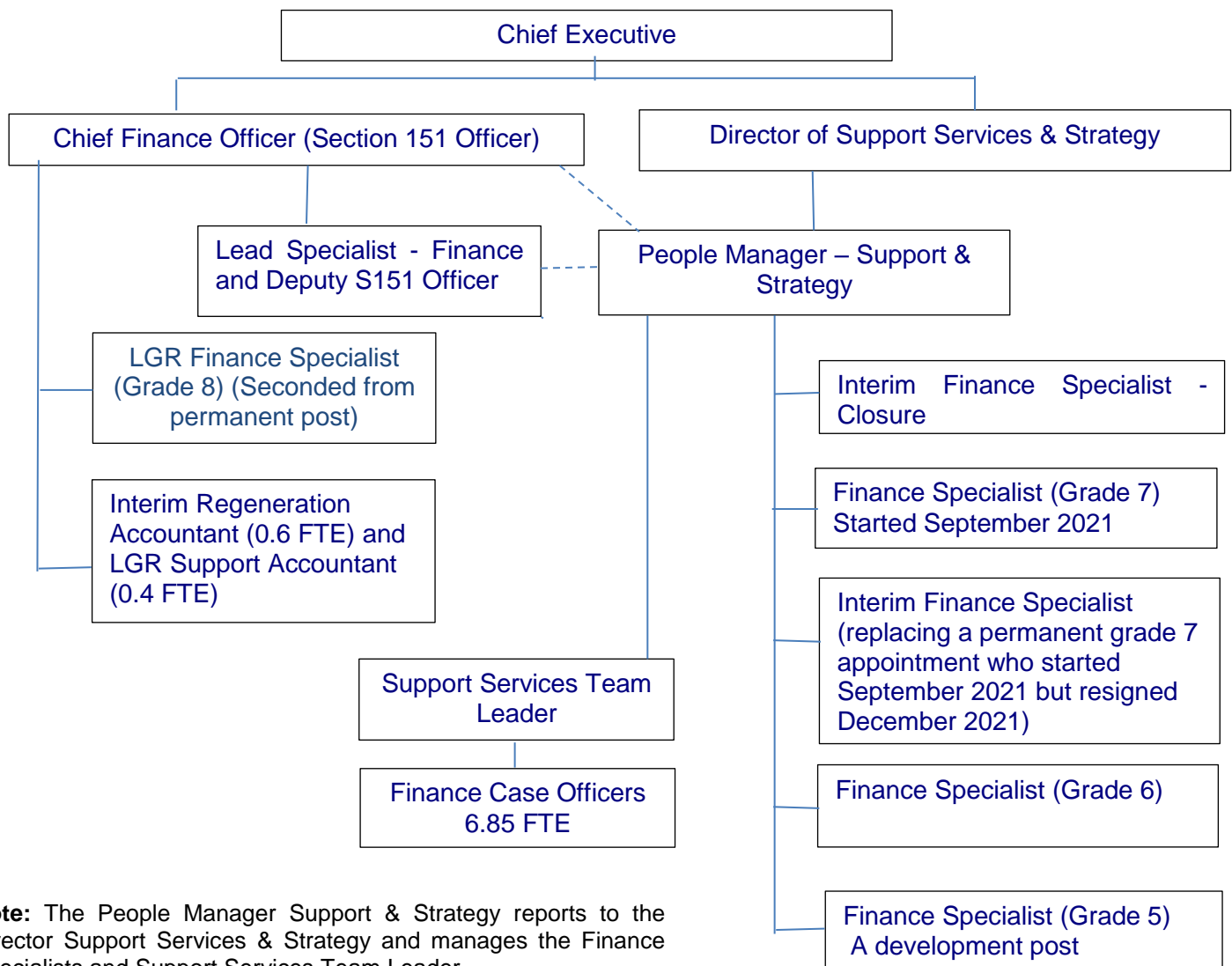
33. The recommencement of Grant Thornton's audit work in 2021 was agreed between Grant Thornton and the Council. Given where we were in the financial cycle this immediately put pressure on the team to undertake the work required to achieve the budget-setting timetable as well as the audit. The Chief Finance Officer subsequently took the decision to prioritise the budget setting work in full knowledge that this would slow down the audit process. The agreement of the annual budget is a key decision as it sets out the budget allocations and funding for service delivery and key corporate priorities. Because of its importance for Elected Members and the need to meet the statutory deadline for agreeing the annual budget and Council Tax, budget work was prioritised over all other work in many instances.
34. The Chief Finance Officer and Lead Specialist Finance did however appoint an experienced close down accountant on an interim basis from January 29th 2022 to end of April 2022, who had worked with the Council before, and who was given the sole task of finalising the audit process from our side. This appointment did have a significantly beneficial impact on progress.



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35. In addition, the budget process undertaken with SLT and District Executive members was more in-depth and iterative than occurred in previous years and this took more finance team time than normal. It was particularly important that SSDC's last budget was as robust as possible and that some historic budgets were reviewed and zero-based prior to these figures being used and consolidated as a starting point for preparing the new Somerset Council's 2023/24 budget.
36. The time needed to participate in the LGR work programme has also increased exponentially from January 2022: affecting significantly the workload of the Chief Finance Officer, the Lead Specialist Finance, and the Finance Specialist grade 8.
37. **Actions/Improvements for 2021/22**: The current capacity and management structure of the finance team is shown in Diagram Two. We have:
 - Shielded the core finance team who will undertake the closure process, as far as possible from LGR work demands, by seconding and employing interim resources on the LGR programme, alongside the Chief Finance Officer and Lead Specialist Finance.
 - Filled seconded and vacant posts with interim appointments who have prior experience of the work they are undertaking. The team is currently fully staffed.
 - Improved the transparency and effectiveness of management responsibilities and accountabilities with a minor restructuring of the service as agreed by Full Council in February 2022 ("*Ensuring sufficient staffing capacity during 2022/23*").

Diagram Two: current Finance Team capacity and management structure



Note: The People Manager Support & Strategy reports to the Director Support Services & Strategy and manages the Finance Specialists and Support Services Team Leader.

It should be noted that the Chief Finance Officer has professional oversight and direction of the work undertaken by the finance teams.

Delays in obtaining information on the value of SSDC Opium Power’s assets

38. A valuation of the company’s assets (battery storage units) is needed to produce group accounts: that is, a consolidated financial position of the council and its subsidiaries. The valuation of such assets is far more complex than valuing operational or investment property as this industry is relatively new. In addition, the valuer also needs input from a specialist “optimiser” who models future income streams arising from the use of the battery storage units given future market projections and assumptions.
39. The situation described above as background is further complicated by the optimisers in this market being unable to share background models, formulas, and assumptions, as the model is essentially their business product and is commercially confidential. This has been the case with the optimiser appointed by SSDC Opium Power upon which the valuer, a separate



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company appointed by SSDC Opium Power, has relied on, after a review, to produce the valuation.

40. This has coincided with the regulator requiring audit firms to focus on the inherent risks on balances that are subject to estimates and judgements and their challenge of the underlying assumptions. Grant Thornton have been required therefore to ask for the detail and formulas behind the summary figures given by the optimiser and this has been a difficult and lengthy process to obtain. It has not helped the situation that the optimiser involved is no longer employed by SSDC Opium Power and the work was done two years ago.
41. Council officers continue to work with SSDC Opium Power, the valuer, and the auditors to resolve this matter, which is now the key item outstanding on the audit.
42. The technical knowledge of how these assets are valued is not something SSDC's finance team nor the core external audit team possess: specific expertise is required. The latter need to use Grant Thornton's specialist valuation team in order to undertake this part of the audit. It is the view of the Chief Finance Officer that this fact has delayed both teams in understanding and articulating what information is exactly required for the audit. Until recently, SSDC's finance team has been simply passing the auditors' requests over to the company and its valuer, and then passing the responses back to the auditors, who then go back to their specialists.
43. **Actions/Improvements for 2021/22:** We will;
 - Continue the more proactive role SSDC has recently undertaken in resolving this issue by inviting all the parties involved to meetings for discussion rather than just relying on email exchanges.
 - Ensure that the deadline for the company and its valuers to prepare the 2021/22 valuation is understood and achievable along with providing the exact information needed by the auditors.
 - Ensure that any contracts the company undertakes for procuring advice from optimisers includes the requirement to share with external auditors under a Non-Disclosure Agreement.

Insufficient quality/completeness of working papers and audit responses

44. The external auditors have raised the issue of working papers and audit responses being of insufficient quality and/or not being fully complete.
45. Given that most of the team were either new or were undertaking new elements of the closure process, their first port of call on preparing a working paper for 2020/21 would be the one produced and audited for 2019/20. However as mentioned in paragraph 37, the additional information and challenge the external auditors were obliged to undertake for 2020/21 (and onwards) by the regulators, did mean that some working papers acceptable in the 2019/20 audit were no longer sufficient for 2020/21.
46. That said, it is the view of the Chief Finance Officer, that considerable improvement can be made to the working papers and that additions can be made to either eliminate or reduce the auditor's questions, in order to increase the overall efficiency of the audit process. In addition, the prior year's working paper, whilst useful as a starting point, should always be reviewed to ensure it is still fit for purpose in the new year's audit process.



47. **Actions/Improvements for 2021/22:** We are:
48. Issuing a Working Paper and Filing Protocol to all those in the organisation that are required to produce information for the statement of accounts and respond subsequently to any questions the auditors may have (this has already been issued to the finance team). This will include an updated format for working papers that will be obligatory for all officers to use and will include new mandatory information requirements: as examples:
- A written description of the purpose of the working paper and where it sits in the production of the Statement of Accounts.
 - Identification of where the information has come from.
 - Identification of any assumptions or professional expertise used in its production.
 - Attachments of emails and/or journal transfers undertaken in producing the working paper.
 - Reference to compliance with Codes of Practice and/or legislation.
 - if there is a financial model involved – then attachment of the model so that the auditors can see formulas and are able to manipulate the data to stress test assumptions.
 - A requirement for the producer of the working paper to review prior year's audit questions to ensure that the questions are addressed in this year's working paper.
 - Date of production, by whom, and date of the quality review undertaken (and who undertook this).
49. Enhancing quality assurance of working papers: either peer-to-peer, amongst the Finance Specialists, or, for significant values and/or where auditors' have raised issues in the past, a more senior review (Interim Closure Finance Specialist, Deputy S151 Officer, or Chief Finance Officer).

Management not implementing prior-period audit recommendations

50. We accept this these were not undertaken. The prior period audit recommendations were:
- Valuation movement between the valuation date and the year-end – management to undertake an exercise using indices to review the movement in value of land and building assets revalued in year.
 - Subsidiary company audit requirement – all the council's subsidiary companies have an annual audit
 - De-minimis Level – a formal policy for the review and agreement of the deminimis level is formally agreed.



51. **Actions/Improvements for 2021/22:**

- We have undertaken the required annual audits for the council's subsidiary for 2020/21 and the audit required for the 2021/22 accounts for all companies has been agreed.
- We have reviewed the de-minimis level as recommended. This was included in the report on Accounting Policies for the 2021/22 statement of accounts, which went to Audit Committee's meeting in March 2022. Audit Committee agreed to revise the limit from £2,000 to £500. The review of accounting policies (including review of the de-minimis limit) will be reviewed by Audit Committee on an annual basis.
- We will ensure that asset valuation movements between the valuation date and year-end are reviewed and reported and will use indices to review any such movements.

Disclosure of the investigation of a previous Director in the Annual Governance Statement

52. The external auditors stated; "our review of the draft Annual Governance Statement (AGS) has identified that the statement does not make reference of the actions of a previous council director who left employment after a series of allegations emerged after the year end. We believe that appropriate wording should be included within the AGS as part of the section on significant governance issues identified in this period".
53. We have now added the following paragraph to the 2020/21 statement: "An issue was identified and investigated during the 2021/22 financial year which related to activities during the 2020/2021 year and previous financial years. Following a full and independent investigation, a former Director of the Council was dismissed in October 2021. Senior Management will be taking a public report on the council's response to the recommendations following the investigation, the actions taken, and the improvements made to our corporate governance arrangements which include tightening our control and monitoring processes, to the meeting of the Audit Committee on 26th May 2022. This will be fully reflected in our Annual Governance Statement for 2021/22.'

Conclusion

54. We accept the need for SSDC to make significant improvements in some areas regarding the production of the accounts and our part in ensuring a subsequent efficient audit process. We have set out in the report that actions we are taking. A final management report will be presented at Audit Committee at its meeting in July 2022 to address the outstanding issues not addressed here, and any new issues included in the final Audit Findings Report.
55. We are committed to deliver the draft statement of accounts for 2021/22, and to work with the auditors to complete our part in the audit, by the agreed deadlines.
56. We are establishing a statutory officers meeting to regularly review progress being made on the 2021/22 process. This will be in addition to existing management oversight arrangements and will involve the Chief Executive, Chief Finance Officer, Monitoring Officer, and the Deputy S151 Officer, with others in attendance as required.
57. We will continue having regular meetings between all the statutory officers and the external auditors, following best practice guidelines, and expect that Grant Thornton will brief us on any future need for them to issue a similar audit findings report in the future.



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58. Both ourselves and the external auditors have the shared goal of ensuring that the overall audit process is undertaken as efficiently as possible whilst meeting all statutory and regulatory requirements. We will explore with Grant Thornton, given this shared goal, aspects of the way the audit was conducted that we feel could be improved by the audit team. Examples include:

- The same audit questions asked from different members of the audit team.
- Audit team members who seemed to have no prior experience of local government audit and asked fairly basic questions, for example how councils are funded, from the finance team rather than from their audit colleagues.
- The need to be very explicit and more informative, at times, about what information the audit team is exactly requiring.

Background Papers

Interim Audit Findings Report from Grant Thornton, Audit Committee, 24th March 2022

Local Government Association: *Update on Local Audit*, 2nd March 2022