



Annual Audit Letter

Year ending 31 March 2018

Devon County Council

14 August 2018



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Your key Grant Thornton
team members are:

Jon Roberts

Partner

T: 0117 305 7699

E: jon.roberts@uk.gt.com

David Bray

Senior Manager

T: 0117 305 7889

E: david.bray@uk.gt.com

Emma Dowler

Audit Executive

T: 0117 305 7619

E: emma.dowler@uk.gt.com

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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 Devon County Council for the year ended 31 March 2018.

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 27 July 2018.

Our work

Materiality	We determined materiality for the audit of the Council's financial statements to be £23.8m, which is 1.9% of the Council's gross expenditure on the provision of services. We determined materiality for the audit of the pension fund accounts administered by the Council to be £40m, which is 1% of the pension fund's net assets.
Financial Statements opinion	We gave an unqualified opinion on the Council's financial statements and an unqualified opinion on the Devon Pension Fund financial statements on 31 July 2018.
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 are required under the Act to give electors the opportunity to raise questions about the Council's financial statements and we consider and decide upon objections received in relation to the accounts. We received one such objection regarding the Council's accounts for the year ended 31 March 2018 and have recently commenced reviewing this. We expect to complete this work by the end of the year.
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 31 July 2018.
Certificate	We are unable to certify that we have completed the audit of the accounts of Devon County Council until we resolve the objection from the member of the public outlined above.

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

Acknowledgement

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 2018

Audit of the Accounts

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 accounts to be £23.8m, which is 1.9% of the Council's gross expenditure on the provision of services. 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 lower levels of specific materiality for senior officer remuneration and related party transactions which were £20,000 and £800,000 respectively.

We set a lower threshold of £1.2m, above which we reported errors to the Audit Committee in our Audit Findings Report.

Pension Fund Materiality

For the audit of the Devon County Pension Fund accounts, we determined materiality to be £40 million, which is 1% of the Fund's net assets. We used this benchmark, as in our view, users of the Pension Fund accounts are most interested in the value of assets available to fund pension benefits.

We set a threshold of £2m, above which we reported errors to the Audit Committee.

We set a lower level of specific materiality for management costs of £156,000.

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 Statement of Accounts and the narrative report, annual governance statement and Annual Report published alongside the Statement of Accounts to check they are consistent with our understanding of the Council and with the financial statements included in the Statement of Accounts 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 is 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 Accounts

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 Under ISA 240 (UK) there is a 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>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"> • 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 Devon County Council, mean that all forms of fraud are seen as unacceptable. 	<p>We do not consider this to be a significant risk for the Council.</p>
<p>Management override of controls 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>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>We identified management override of controls as a risk requiring special audit consideration.</p>	<p>We have undertaken the following work in relation to 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, carried out a full analysis to identify and test unusual journal entries for appropriateness; • evaluated the rationale for any changes in accounting policies or significant unusual transactions; • reviewed unusual significant transactions; and • reviewed any significant related party transactions outside the normal course of business. 	<p>Our work did not identify any issues in respect of management override of controls.</p>

Audit of the Accounts

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 property, plant and equipment The Council revalues its land and buildings on an quinquennial basis 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 undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> • reviewed the competence, expertise and objectivity of the management expert used; • reviewed the instructions issued to valuation experts and the scope of their work; • reviewed and challenged the information used by the valuer to ensure it was robust and consistent with our understanding; and • tested that revaluations made during the year 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; and • reviewed the accounting entries for the revaluation reserve. 	<p>Our work did not identify any issues in respect of the valuation of property, plant and equipment.</p>
<p>Valuation of pension fund net liability 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 undertaken 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; and • reviewed the consistency of the pension fund net liability disclosures in notes to the financial statements with the actuarial report from the Council's actuary. 	<p>Our audit work has not identified any issues in respect of the valuation of the pension fund net liability.</p>

Audit of the Accounts

Pension Fund Significant Audit Risks

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Improper revenue recognition</p> <p>Under ISA 240 (UK) there is a 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>Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Pension Fund, we have 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 Devon County Council as the administering authority, mean that all forms of fraud are seen as unacceptable. 	<p>Our audit work has not identified any issues in respect of revenue recognition.</p>
<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.</p> <p>We identified management override of controls as a risk requiring special audit consideration.</p>	<p>We have undertaken the following work in relation to 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, identified and tested unusual journal entries for appropriateness; • evaluated the rationale for any changes in accounting policies or significant unusual transactions; and • reviewed any significant related party transactions outside the normal course of business. 	<p>Our audit work has not identified any issues in respect of management override of controls.</p>

Audit of the Accounts

Pension Fund Significant Audit Risks

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>The valuation of Level 3 investments is incorrect</p> <p>Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.</p> <p>We identified the valuation of level 3 investments as a risk requiring special audit consideration.</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> gained an understanding of the Fund's process for valuing Level 3 investments and evaluated the design of the associated controls; challenged management regarding the categorisation of Level 3 investments; reviewed the nature and basis of estimated values and considered what assurance management has over the year end valuations provided for these types of investments; considered of the competence, expertise and objectivity of the management experts used; reviewed the qualifications of the experts used to value the Level 3 investments at the year end and gained an understanding of how the valuation of these investments had been reached; assessed the potential impact of two 'emphasis of matter' paragraphs from the external auditors in two of the sets of financial statements that supported the Level 3 investments on the values attached to those investments; and for all of the Level 3 investments, tested the valuation by obtaining and reviewing the audited accounts at the latest date for individual investments and agreeing these to the fund manager reports at that date; we also reconciled those values to the values at 31 March 2018 to the figures provided by the Pension Fund's custodian. 	<p>Our audit work did not identify any issues in respect the valuation of Level 3 investments.</p>

Audit of the Accounts

Audit opinion

We gave an unqualified opinion on the Council's financial statements on 31 July 2018, in line with the national deadline.

Preparation of the accounts

The Council presented us with draft accounts 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 accounts

We reported the key issues from our audit to the Council's Audit Committee on 27 July 2018.

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 did not identify any issues for the group auditor to consider on 14 August 2018.

Pension fund accounts

We gave an unqualified opinion on the pension fund accounts of Devon Pension Fund on 31 July 2018.

We also reported the key issues from our audit of the pension fund accounts to the Council's Audit Committee on 27 July 2018.

Other statutory powers

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

As reported on page 3 of this Letter, we received an objection regarding the Council's accounts for the year ended 31 March 2018 and have recently commenced reviewing this. We expect to complete this work by the end of the year.

Certificate of closure of the audit

We are unable to certify that we have completed the audit of the accounts of Devon County Council until we resolve the objection outlined above.

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 key risks where we concentrated our work.

The key 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 2018, we agreed one recommendation to address our findings. This is included in Appendix B.

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 2018.

Value for Money conclusion

Key Value for Money Risk

Risk identified in our audit plan	How we responded to the risk	Findings and conclusion
<p>Strategic Financial Planning</p> <p>The ongoing challenge of meeting the savings outlined by Central Government continue to put pressures on Local Government finances.</p> <p>Nationally, the continued pressure from Adult and Children's services has resulted in significant overspends and further enforces the need to identify alternative methods of achieving councils' financial positions in the future.</p> <p>At the time we undertook our planning in January 2018, we envisaged that the delivery of the Council's medium term financial plan would be reliant on its transformational programme, which was expected to become operational from 2019/20. At the time of planning we felt the risk was that the Council's future financial resilience would be overly dependent on its transformation plan, which was, as yet, unproven in its effectiveness. We therefore planned to undertake work in this area.</p>	<p>We completed the following work:</p> <ul style="list-style-type: none"> • reviewed the latest medium term financial strategy (MTFS); • considered the year end position for 2017/18, including delivery of planned savings; and • considered the ongoing funding challenging and how gaps in the MFTS will be addressed going forward. <p>The Council was able to transfer £12m into reserves and achieve a surplus of £15,000 in 2017/18. It was able to do this as it delivered in the region of £20.8m in savings and achieved additional funding such as the Better Care Fund and was overspent in just one area, Children's services.</p> <p>The Council has been working within a number of areas to identify new ways of working that will deliver savings through the transformation programme. However, the current funding gaps within the MTFS are not reliant on transformation programme and for the short term the Council continues to be able to deliver its savings through more traditional approaches.</p>	<p>The Council's MTFS in 2019/20 is not reliant on its transformation programme and it anticipates that its savings can be met by traditional approaches in 2019/20. Because of this we were satisfied that the Council's future financial resilience was not currently impacted by uncertainty over the eventual effectiveness of its transformation activities. The outturn position for 2017/18 also provided an opportunity to increase the level of reserves and provide a short-term safety net should the savings gaps not be identified. The Council recognises that given the savings that have been achieved to date, future savings will be increasingly difficult to achieve.</p> <p>The Council continues to make steady progress with its transformation programme and anticipates that savings from this programme will be identified in 2019/20 with more significant savings being achieved in 2020/21. This should enable the Council to begin to include transformation programme savings within the MTFS. The process is a bottom-up, pilot based approach and as such the Council expects that a much higher percentage of savings should be achievable as the Council will have accurately quantified the savings using the pilots projects.</p> <p>The Council should continue to actively monitor progress to ensure it identifies and begins to deliver savings in 2019/20.</p>

A. Fees and Reports Issued

We confirm below the fees charged for the audit and confirm no non-audit related services have been undertaken for the Council.

Fees

	Planned £	Actual £	2016/17 £
Statutory Council audit	105,281	105,281	105,281
Audit of Pension Fund	28,603	28,603	28,603
Total Audit Fees	133,884	133,884	133,884
Certification:			
Teachers Pensions return*	4,200	TBC	4,200
School-centred initial teacher training (SCITT) claim*	3,700	TBC	3,700
Objection Costs:			
Balance of Fee for 2015/16 objection		7,058	15,000
Fee for 2016/17 objection		7,993	0
Total fees	141,784	TBC	156,784

Notes

The planned fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA)



* Certification work will be undertaken later in the year.

Reports issued




Report	Date issued
Audit Plan	February 2018
Audit Findings Report	July 2018
Annual Audit Letter	August 2018

B. Recommendations

We have identified two 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 2018/19 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 the Council in accordance with auditing standards.

Assessment	Issue	Recommendation
<p>1</p> <p> Amber</p>	<p>The Council's financial statements include details of critical judgements it has applied when applying its accounting policies.</p> <p>In our view not all of these judgements were critical as they would have a material effect on the accounts.</p>	<p>The Council should review its critical judgements in 2018/19 to ensure that they are appropriate and do have a material impact on the Council's accounts.</p> <p>Management response</p> <p>The content of Critical Judgements has accumulated over a number of years, partly as a result of previous audit recommendations. The Council will review critical judgements in 2018/19.</p>
<p>2</p> <p> Amber</p>	<p>The Council continues to make steady progress with its transformation programme. These savings are likely to become a key part of the Council's medium term financial plan.</p>	<p>Monitor progress against the transformation programme to ensure it is having the desired impact on both service delivery and financial savings to the Council and its key partners.</p> <p>Management response</p> <p>Agreed.</p>

Controls

-  High – Significant effect on control system (Red)
-  Medium – Effect on control system (Amber)
-  Low – Best practice (Green)



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