

South Derbyshire District Council

Audit progress update

4 March 2024

Overview

This paper seeks to update members of the Audit Sub-Committee on the progress of the external audit for the 2021/22 and 2022/23 financial years.

Local audit market update

There is general agreement that the backlog in the publication of audited financial statements by local bodies has grown to an unacceptable level and there is a clear recognition that all stakeholders in the sector will need to work together to address this. DLUHC has worked collaboratively with the FRC, as incoming shadow system leader, and other system partners, to develop measures to clear the backlog. The proposals, which have been developed to maintain auditor independence and enable compliance with International Standards on Auditing (UK) (ISAs (UK)), consist of three phases:

- ▶ Phase 1: Reset involving clearing the backlog of historic audit opinions up to and including financial year 2022/23 by 30 September 2024.
- ▶ Phase 2: Recovery from Phase 1 in a way that does not cause a recurrence of the backlog by using backstop dates to allow assurance to be rebuilt over multiple audit cycles.
- ▶ Phase 3: Reform involving addressing systemic challenges in the local audit system and embedding timely financial reporting and audit.

To support the further development and testing of the measures, consultations are taking place to receive further feedback and inform the decision on how to proceed. Specifically:

- ▶ DLUHC has launched a consultation on changes to the Accounts and Audit Regulations 2015 to insert statutory backstop dates for historic financial statements and for the financial years 2023/24 to 2027/28.
- ▶ The National Audit Office (NAO) has launched a consultation on amending the Code of Audit Practice to:
 - ▶ Require auditors to issue audit opinions according to statutory backstop data for historic audits, and place specific duties on auditors to co-operate during the handover period for the new PSAA contract for the appointment of local authority auditors covering the years 2023/24 to 2027/28.
 - ▶ Allow auditors to produce a single value for money commentary for the period to 2022/23 and use statutory reporting powers to draw significant matters to the attention of councils and residents.
- ▶ The Chartered Institute of Public Finance and Accountancy (CIPFA) is expected to launch a consultation on temporary changes to the accounting code for preparation of the financial statements. The proposed temporary changes to the financial reporting framework have an impact on both how the financial statements are prepared and the audit procedures necessary to gain assurance.

As a result of the system wide implementation of backstop dates it is likely that the outcome will be that we will issue a disclaimer of opinion on the Council's 2021/22 and 2022/23 financial statements. The proposed disclaimer/qualification of the Council's 2021/22 and 2022/23 accounts will likely impact the audit procedures needed to gain assurance on the 2023/24 financial statements and the form of your audit report in 2023/24 and subsequent years during the recovery phase, which should be discussed with your auditor for 2023/24 and beyond.

Progress update

As set out in the letter from Stephen Reid, Partner, UK Head of Public Sector Audit, dated 6 December 2023, we have been prioritising our limited resources to maximise assurances whilst guidance has been awaited.

For South Derbyshire District Council this has meant focusing on Value for Money procedures for 2021/22 and 2022/23, given there were no anticipated changes to value for money reporting requirements, auditors' exception reporting responsibilities and statutory powers.

The value for money work usually leverages certain elements of our audit of the financial statements – as this is unable to go ahead at this time, we have needed to perform certain aspects that would traditionally have been performed during the financial statements audit. In addition, we are undertaking procedures such as agreeing the financial statements to the trial balance, completing the disclosure checklist and our cash and cash equivalents work (focused on review of bank reconciliations). In the context of the reset of the local government sector, these additional procedures aim to provide some additional assurance to members.

Our procedures are substantially complete and are subject to finalisation of our review procedures. Our initial observations include:

1. Budget setting

During 2021/22 internal audit identified a significant risk finding where they concluded that *"The annual General Fund, Housing Revenue Account and Capital budgets were not formally received and approved by Full Council, as required by the Council's Constitution and to meet the requirements of the Local Government Act 2000"*. This has also been included in the Annual Governance Statement for 2021/22, along with details of remedial action.

Article 4 of the Constitution states that Full Council will exercise certain functions, which include the following relating to the budgets:

- ▶ To approve and adopt the Council's Revenue Budget (General Fund and Housing Revenue Account);
- ▶ To approve and adopt the Council's Capital programme (General Fund & Housing);

From review of the Council meeting minutes of 24 February 2021 there is no evidence that the full budgets for the General Fund, Housing Revenue Account and the Capital programme have been received and approved by Council.

Given that the approval of the budget is a statutory requirement of full council we consider this to be evidence of a significant weakness in relation to Governance- how the body ensures that it makes informed decisions and properly manages its risks, specifically related to how the body approaches and carries out its annual budget setting process.

We are currently considering the above with management before reaching a formal conclusion and are reviewing the process for subsequent financial years. Whilst we can see that the 2022/23 General Fund budget was included in the papers to Full Council on 23 February 2022 and that this was approved, the budgets for the Housing Revenue Account and Capital Programme appear to have been omitted.

As a result of the above we have identified a risk of significant weakness for 2021/22 and 2022/23 and are likely to report on an exception basis that there is an identified significant weakness in the budget setting process as set out above.

We will also need to consider whether the matter constitutes non-compliance with laws and regulations and any further procedures required as a result.

Management response:

The auditors' findings, subject to further investigation, are accepted. The 2024/25 budget setting has complied in full with the statutory requirements of the Local Government Act, with approvals at its meeting on 28 February 2024. This has included separate decisions in relation to approval of the:

- ▶ General Fund revenue budget
- ▶ Housing Revenue Account revenue budget
- ▶ General Fund and HRA Capital Programmes
- ▶ Council Tax setting
- ▶ Rent setting
- ▶ Fees and charges
- ▶ Treasury Management Strategy
- ▶ Capital Strategy
- ▶ Non-Treasury Investment Strategy
- ▶ Prudential Indicators
- ▶ Minimum Revenue Provision Policy.

We are currently considering the position in previous years with the External Auditor. This includes the findings of the Auditor's Annual Report for the Year ended 31 March 2021, which was issued in June 2023, which stated that the budget once completed was approved by Council.

2. Inspection period

In September 2023 we identified that the inspection period for the 2021/22 financial statements had not been publicized and undertaken. We notified management of this on 28th September 2023 and they acted and published the accounts for inspection from 22nd November 2023 to 10th January 2024.

Management response:

The auditors' findings are accepted. Appropriate steps to resolve this matter were taken immediately once identified, with the publishing of the accounts' inspection notice on 28 September 2023.

3. Risk management

During our discussion with officers and review of the Council's risk management process and risk registers we have identified that there are three risk registers (Corporate, Chief Executive and Services) comprising of over 50 risks that are monitored via the Council's committees.

Whilst there is evidence of these risks being monitored and managed, there is a risk that the most strategic risks impacting the Council are not given due regard or attention. The Council should evaluate whether the current risk management structure is delivering efficient and effective risk management, and whether it is clear what the most strategic risks are to the organisation and what committees those risks be should be received by.

Management response:

The auditors' findings are accepted and a review of the Council's risk management process is underway.

4. Medium Term Financial Planning Strategy

During our discussion with officers and review of the MTFP we have identified that the Council does not have a formal strategy in place for its MTFP. From review of the MTFP we note that whilst potential risks are identified and the impact of these on the expected financial outturn and reserves position is detailed, no information is included on longer term financial management of this position, strategies to mitigate risks and implications for the Council.

Management response:

The auditors' findings are accepted. A Medium-Term Financial Strategy is tabled for consideration by the Finance and Management Committee on 14 March 2024 and is subject to Council approval on 11 April 2024.

Transition to your new auditor

Our proposed approach is designed to ensure that we can effect the reset successfully and then enable capacity to support the system recovery by focusing on the most recent year's financial statements, being 2023/24, and getting the audit timetables back on track. We therefore encourage engagement with your newly appointed auditor to commence your audit of 2023/24 to support a sustainable recovery of the audit arrangements across the sector and, importantly timely reporting to the Council.