

12 February 2025

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Dear Chris

East Devon District Council: Conclusion of the audit for 2023/24 – letter to those charged with governance on the application of the local authority backstop 2023/24

As you will be aware, on 30 September 2024 parliament approved the Accounts and Audit (Amendment) Regulations 2024. These Regulations set a publication date for financial statements up to and including 2022/23 by 13 December 2024, and for audit year 2023/24 by 28 February 2025. The new National Audit Office Code which was approved on 14 November 2024 also requires that auditors should issue their audit report in time for the relevant authority to publish its accounts by the specified date in those Regulations. Where audit work is not concluded, this will result in either a qualification or disclaimer of opinion.

As discussed with your Finance Director and the Audit & Governance Committee, and for reasons which I set out in more detail below, it will not be possible for us to complete our audit for 2023/24 by the statutory backstop date.

We are required under the Auditing Standards to report certain matters to the Audit & Governance Committee, including our responsibilities as auditor, the scope of the audit, independence, audit fees and any matters arising from the audit. I set out more details on the audit below. Information regarding our responsibilities, the scope of the audit and fees are included in Appendix A.

Outcome of our audit for 2023/24 – Disclaimer of the opinion on the financial statements

Unfortunately for reasons set out below, it will not be possible for us to undertake sufficient work to support an audit opinion by the statutory deadline of 28 February 2025. This means that the limitations of scope imposed by the backstop are pervasive and therefore we have been unable to form an opinion on the financial statements by the due date. We therefore plan to issue a disclaimer of the audit opinion. We have attached the draft wording of our Audit Report for your information in Appendix C.

The Authority were required to produce their financial statements for 2023/24 by 31 May 2024. The draft accounts were not published until the 14 August 2024. Our post statements audit commenced in September 2024 with the aim of concluding the detailed testing by the 31 December 2024. However, the Council was not able to support the audit process, and we were not furnished with timely of complete responses to a large number of our audit queries. This was compounded by the departure of a member of the finance team five weeks into the audit, who had played a key role in the production of the draft accounts. This resulted in a further gap in capacity and capability within the finance team to service the audit.

Chartered Accountants

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2023/24 was always going to be a challenging audit given that both 2021/22 and 2022/23 were backstopped. The inability to conclude prior year audits necessitated further work in 2023/24 on opening balances as well as large sample sizes due to the absence of prior year assurances. It is also fair to say that the Council has not gone through a full audit for a number of years and the level of audit scrutiny and challenge continues to increase each year.

On the 18 December 2024, we communicated to management that there was insufficient time to undertake a compliant audit in the time available. Based on experience, we judged it to be highly improbable that we would complete our work by 28 February 2025 deadline. We therefore agreed with management that we would prioritise our work in areas that we were most likely to be able to complete in the time available. As planned, our testing focussed on journals, cash and cash equivalents, and valuation of council dwellings. However, as documented within Appendix B, we were unable to conclude on these areas as well due to the challenges highlighted earlier.

Outcome of this year's audit - Value for Money work and other work under the National Audit Office Code of Audit Practice

We commenced our Value for Money work in May 2024 and concluded in November 2024.

We reported the outcome in our Interim Annual Audit Report dated 8 November 2024. Our Interim Annual Audit Report was presented to the Audit Scrutiny Committee on 27 November 2024.

The key findings for the year, as set out in our Interim Annual Audit Report, noted two significant weaknesses in relation to financial sustainability and governance as follows:

Financial sustainability – Housing Revenue Account (HRA)

The Council has unidentified savings/funding gaps in financial planning that substantially threaten operation of the HRA. There were significant inconsistencies between budgetary information and the Council's predicted financial outturn position in 2022/23, 2023/24 and 2024/25. The HRA outturn for 2023/24 shows a significant budget overspend. The Revenue budget was overspent by £7.1m, the Capital Programme budget was overspent by £5.1m. The Council has had to borrow an additional £2.5m to fund the Capital overspend.

There has also been unsustainable use of reserves to plug the budget gaps to the extent that there are now no useable reserves left from which to plug the anticipated budget shortfall in 2024/25. The £9.4m earmarked reserves utilised in 2023/24 included money set aside for new homes and climate change development work and Fire Risk Assessment Building works and Lift replacements. As at 31 March 2024 the Council therefore no longer had money any reserves set aside to pay for any of these items. The Council has made provision for these items in the revised 2024/25 and 2025/26 budgets, however, this will require additional borrowing of £7.3m in 2024/25 as well as utilising a further £1.75m of reserves. This will leave the reserves balance in a precarious state. Historically the Council has maintained a minimum reserves balance of £3.1m to provide a buffer against unexpected expenditure. The Council has now recalculated its minimum reserve balance down to £2.1m. The planned use of those reserves in 2024/25 will reduce the reserves balance to £1.35m. This is below even the new minimum reserves level and less than half the previous minimum reserves balance set by the Council.

This represents a worsening position and significant deterioration in the financial sustainability of the HRA in the short time that has elapsed since our 2022/23 Auditors Annual Report in March 2024.

Based on the work undertaken and evidence reviewed, we are not satisfied that the Council has proper arrangements in place to secure financial sustainability in 2023/24. We have therefore identified a significant weakness in arrangements and raise the following key recommendation.

- The Council needs to review all assumptions and models used in developing the 2024/25 budget to ensure it has an accurate and robust base budget. The Council also needs to update and agree a sustainable HRA business plan as a matter of urgency and ensure that prudent levels of HRA reserves are maintained over the medium term by mitigating the impact of annual deficits on reserves. That plan should reflect the maintenance requirements of the housing stock condition survey, decarbonisation programme and other financial pressures.

Governance – Preparation and audit of Accounts

As reported in our 2020/21 Audit Findings Report dated November 2023, delays were encountered and additional work required to conclude the audit, resulting in our opinion not being issued until 2 November 2023. The Council recognised that there have been historic capacity issues within the finance team which combined with national technical issues and subsequent audit team changes that compounded the delay. Whilst not alone in finding itself with prior year unaudited accounts, the focus going forward for both councils and auditors must be timely accounts production and audit completion.

The 2022/23 accounts were not published until 21 May 2024 and there were similar delays in 2021/22. We have agreed with the Council to backstop the 2021/22 and 2022/23 opinion audit. This should enable an earlier start on the 2023/24 post-statements audit.

The Council had initially committed to producing draft 2023/24 financial statements by the end of May 2024 deadline, these were provided 2.5 months later on 14 August 2024.

The absence of external validation of the financial statements means there is a risk that decisions made by the Council will not be based on clear and accurate financial information.

Based on the work undertaken and evidence reviewed, we are not satisfied that the Council has proper arrangements in place relating to Governance in 2023/24.

We have therefore identified a significant weakness in governance arrangements and raise the following key recommendation.

- The Council should ensure that the annual draft accounts together with associated working papers are published in accordance with the national timetable.

Since issuing our 2023/24 Interim Auditors Annual Report we have now agreed to backstop the 2023/24 opinion audit resulting in 3 years of audits dating back to 2021/22 being disclaimed.

Independence

Ethical Standards and ISA (UK) 260 require us to give you timely disclosure of all significant matters that may bear upon the integrity, objectivity and independence of the firm or covered persons (including its partners, senior managers, managers). In this context, we confirm that there are no significant facts or matters that impact on our independence matters as auditors that we are required or wish to draw your attention and consider that an objective reasonable and informed third party would take the same view.

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements. Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in May 2020 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

Management letter of representation

We have asked management to provide a letter of representation in respect of the financial statements covering 2023/24. This will be tabled as a separate agenda item.

Looking ahead

The circumstances resulting in the application of the local authority backstop are clearly extremely unusual. The government has signalled its intent that where backstops have been applied, local authorities and their auditors work together to recover the position over subsequent years. We will follow relevant guidance including from the NAO and the FRC to work with you over the coming year, as we seek to rebuild audit assurance.

Yours sincerely

Peter Barber

For Grant Thornton UK LLP

cc: - Finance Director (Section 151 Officer)

Attachments:

Appendix B - Status of the audit testing,

Appendix C - Draft Disclaimer of Opinion, and

Appendix D - Letter of Representation

Appendix A - Communication of audit matters to those charged with governance

Responsibilities

The National Audit Office ('the NAO') has issued a document entitled Code of Audit Practice ('the Code'). This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. Our respective responsibilities are also set out in the Terms of Appointment and Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA), the body responsible for appointing us as auditor of East Devon District Council. We draw your attention to both of these documents.

Scope of our audit

The scope of our audit is set in accordance with the Code and International Standards on Auditing (ISAs) (UK). We are responsible for forming and expressing an opinion on the Council's financial statements that have been prepared by management with the oversight of those charged with governance (the Audit & Governance Committee); and we consider whether there are sufficient arrangements in place at the Council for securing economy, efficiency and effectiveness in your use of resources. Value for money relates to ensuring that resources are used efficiently in order to maximise the outcomes that can be achieved.

The audit of the financial statements does not relieve management or the Audit & Governance Committee of its responsibilities. It is the responsibility of the authority to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the authority is fulfilling these responsibilities.

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

Audit Plan

We issued an Audit Plan on 10 July 2024. In our plan we identified the following issues as significant audit risks:

- Risk of fraud in revenue recognition (rebutted).
- Risk of fraud in non-pay operating expenditure and associated creditor balances (rebutted).
- Management over-ride of controls
- Valuation of land and buildings
- Valuation of Council dwellings
- Valuation of investment property
- Valuation of pension net fund liability/ surplus.

We have not identified any other significant risks since the date we issued our audit plan.

Our approach to materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law.

For 2023/24, we set a materiality level of £1.6million.

Key financial reporting and audit issues identified during the audit

We have summarised the status of audit testing on key areas of the financial statement (see Appendix B). As we have not concluded on key areas of the audit, we do not provide assurance on any area or balance of the accounts given we have not been able to triangulate our findings with other audit work we would normally have undertaken.

We have identified 3 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 2024/25 audit. The matters reported here are limited to those deficiencies that we have identified during the course of our audit and are of sufficient importance to merit being reported to you in accordance with auditing standards.

Assessment	Issue and risk	Recommendations
Medium	<p><u>Journals</u></p> <p>The Council does not have a process in place for the review of all the journal postings. There is a risk that inappropriate or incorrect journals could be posted as a result of a lack of review.</p>	<p>We recommend that management considers implementing a review process to identify any incorrect journal posting.</p> <p><u>Management response:</u> Considered low risk but review process will be implemented.</p>
Medium	<p><u>Council Dwellings</u></p> <p>The audit team noted a difference of nearly £8m between the valuation report for Council Dwellings and the Fixed asset register. This £8m variance is related to the major repairs during the year in the council dwellings which should have been covered as part of the valuation. However, management has added the major repairs to the valuation figure and plan to reverse this in the following year. This is an incorrect accounting treatment as per the CIPFA code.</p>	<p>We recommend that management provide the details of major repairs to the valuer such that this can be incorporated in the valuation report.</p> <p><u>Management response:</u> Implementation will be made following review of CIPFA guidance and currently following previous external audit advice with regard to treatment.</p> <p>Practical implications are also being considered regarding the timing of the valuation work and adhering to tight timescales. This is possibly 1000s of lines of capital enhancement expenditure to be allocated to individual properties and each impacted property requiring valuation. We need to question the necessity of this and whether existing practice is within the code as the effect will be captured in following year valuations.</p>
High	<p><u>Bank Reconciliation</u></p> <p>The audit team noticed 4 cash control accounts as part of bank reconciliation. The balance on these control accounts were £12.6m, -£107m, -£2.4m and £94.9m. These control accounts were netted off to reach at a net balance of £1.8m which was then included as part of the Council's bank reconciliation process. The audit team identified long standing bank reconciling items in these cash control accounts, some dating back to 2005. Due to not clearing down the balance of these control accounts, there was a difference in reconciliation of £124k. Upon enquiry, these control accounts appear not to be included within the Councils procedures for reconciling and clearing down as part of bank reconciliation procedures.</p>	<p>We recommend that management reconcile these cash control accounts on a timely and regular basis.</p> <p><u>Management response:</u> Implementing change in process/procedures to clear down the control code balances on a regular basis rather than the current accumulating totals.</p>

Going Concern

As auditors, we are required to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern (ISA (UK) 570).

In performing our work on going concern, we have had reference to Statement of Recommended Practice – Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom (Revised 2020). The Financial Reporting Council recognises that for particular sectors, it may be necessary to clarify how auditing standards are applied to an entity in a manner that is relevant and provides useful information to the users of financial statements in that sector.

Practice Note 10 sets out the following key principles for the consideration of going concern for public sector entities:

- the use of the going concern basis of accounting is not a matter of significant focus of the auditor's time and resources because the applicable financial reporting frameworks envisage that the going concern basis for accounting will apply where the entity's services will continue to be delivered by the public sector. In such cases, a material uncertainty related to going concern is unlikely to exist, and so a straightforward and standardised approach for the consideration of going concern will often be appropriate for public sector entities
- for many public sector entities, the financial sustainability of the reporting entity and the services it provides is more likely to be of significant public interest than the application of the going concern basis of accounting. Our consideration of the authority's financial sustainability is addressed by our value for money work, which is covered elsewhere in this report.

Practice Note 10 states that if the financial reporting framework provides for the adoption of the going concern basis of accounting on the basis of the anticipated continuation of the provision of a service in the future, the auditor applies the continued provision of service approach set out in Practice Note 10. The financial reporting framework adopted by a local authority meets this criteria, and so where undertaking work on your audit, we would normally expect to apply the continued provision of service approach. In doing so, we would consider and evaluate:

- the nature of the authority and the environment in which it operates
- the authority's financial reporting framework
- the authority's system of internal control for identifying events or conditions relevant to going concern
- management's going concern assessment.

As we have been unable to form an opinion on the financial statements, we are unable to draw a conclusion in this area.

Design effectiveness of internal controls

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to management.

We have identified two control weaknesses that needs to be reported. These control weaknesses are related to cash control account and journal that has been highlighted in the Key financial reporting and audit issues identified during the audit section above. We have no further matters to report.

Other matters which we are required to report on to those charged with governance

We are required to confirm the following:

- We have not been made aware of any incidents of fraud in the period and no issues have been identified during the course of our audit procedures.
- We are not aware of any related party transactions which have not been disclosed.
- We are not aware of any significant incidences of non-compliance with applicable laws and regulations.

Audit fees and non-audit fees

PSAA set a scale fee for this the year ended 31 March 2024 of £149,679. Our planning assumption based on additional requirements under auditing standards resulted in an indicative fee of £157,209.

Given the unusual circumstances of the backstop, we are awaiting a determination from PSAA as to the appropriate fee to be charged for the 2023/24 audit year.

Our planning assumption was that 2023/24 would be a full audit. Our planning work was completed in April 2024 and we issued our Audit Plan in July 2024. We then utilised our full post-statements resource between September 2024 and January 2025 in seeking to conclude the audit. Since January 2025 we have focused our work on undertaking the closing audit procedures to enable us to issue our backstop opinion. As a result the audit time expended on the audit was more than the budget despite us being unable to conclude our work.

From a VFM perspective a full VFM audit has been undertaken culminating in the issuing of our Interim Auditor Annual Report for 2023/24 in November 2024.

Our current estimate of final fee for the year is set out below and are based on estimated costs incurred to date. Final fees will be determined by PSAA and we will update the Council in due course once their final determination is made.

Estimated 2023/24 audit fees which included VFM, communication and reporting (including issuing the backstop opinion) are £160,000.

Non audit fees

We have also undertaken the following non audit work in respect of following years that were in progress since the start of 2023/24.

Audit Service	Proposed Fee	Final Fee
2021/22		
Housing Benefits Return	£24,165	£24,165
Housing Pooling Receipts Return	£5,000	£5,000
2022/23		
Housing Benefits Return	£30,000 + £935 per day for additional testing	Work underway
2023/24		
Housing Benefits Return	£32,000 + £935 per day for additional testing	Not started

*TBC represents areas where work is still on-going or yet to begin.

No Housing Pooling Receipts work has commenced for either 2022/23 or 2023/24. We have offered to undertake both years audits but have not heard back from the Council.

We were unable to reconcile the fees above to the draft 2023/24 financial statements presented for audit.

The level of these recurring non-audit fees taken on their own is not considered a significant threat to independence in comparison to the total original planned fee for the audit of £157,209 and in particular relative to Grant Thornton UK LLP's turnover overall. Further there is no contingent element to it. These factors all mitigate any perceived self-interest threat to an acceptable level.