



# The Annual Audit Letter for Exeter City Council

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Year ended 31 March 2019

2 March 2020



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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 Exeter City Council ( the Council) and its subsidiaries (the group) for the year ended 31 March 2019.

This Letter is intended to provide a commentary on the results of our work to the group 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 and Governance Committee as those charged with governance in our Audit Findings Report on 28 January 2020.

### Our work

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<b>Materiality</b>	We determined materiality for the audit of the group's financial statements to be £1.95m, which is 1.8% of the group's gross revenue expenditure. The materiality we applied to the Council's financial statements was £1.8m.
<b>Financial Statements opinion</b>	We gave an unqualified opinion on the group's financial statements on 31 January 2020.
<b>Whole of Government Accounts (WGA)</b>	We completed work on the Council's consolidation return following guidance issued by the NAO.
<b>Use of statutory powers</b>	<p>We are required under the Act to give electors the opportunity to raise questions about the group's financial statements and we consider and decide upon objections received in relation to the financial statements.</p> <p>We have been in communication with a member of the public who has asked us, as the appointed auditor, to look into grant monies paid to a community organisation in 2018/19.</p> <p>We are currently considering this request. Given the sums involved and the small number of similar grant approvals we do not believe that this issue materially impacts on either our opinion on your financial statements or the VFM conclusion. We will, however, hold open our certificate confirming completion of the 2018/19 audit until we have concluded on this matter.</p> <p>To date, we have not exercised any of our additional statutory powers or duties.</p>

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

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# Executive Summary

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<b>Value for Money arrangements</b>	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 Findings Report which we presented on 28 January 2020.
<b>Certification of Grants</b>	We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions (DWP) and of the Council's Pooling of Housing Capital Receipts return. These were both certified without amendment or qualification by the respective deadlines of 30 November 2019 and 7 February 2020.
<b>Certificate</b>	We are unable to certify that we have completed the audit of the financial statements of Exeter City Council until we resolve the matter raised by a member of the public relating to monies paid to a community organisation in 2018/19.

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**Grant Thornton UK LLP**  
**March 2020**

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# Audit of the Financial Statements

## Our audit approach

### Materiality

In our audit of the group'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 group financial statements to be £1.95m, which is 1.8% of the group's gross revenue expenditure. We determined materiality for the audit of the Council's financial statements to be £1.8m, which is 1.8% of the Council's gross revenue expenditure in the previous financial year. We used this benchmark as, in our view, users of the group and Council's financial statements are most interested in where the group and Council has spent its revenue in the year.

We also set a lower level of specific materiality for senior officer remuneration of £5,000.

We set a lower threshold of £97,500 for the group and £90,000 for the Council, above which we reported errors to the Council's Audit and Governance 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 and the narrative report, 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 group'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><b>Improper revenue recognition</b></p> <p>Under ISA (UK) 240 there is a rebuttable 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 Authority, when producing our audit plan we determined that the risk of fraud arising from revenue recognition can be rebutted because:</p> <ul style="list-style-type: none"> <li>• there is little incentive to manipulate revenue recognition</li> <li>• opportunities to manipulate revenue recognition are very limited</li> <li>• the culture and ethical frameworks of local authorities, including Exeter City Council, mean that all forms of fraud are seen as unacceptable.</li> </ul> <p>We reviewed this assessment during the course of our audit and no new information has come to light to change our original assessment.</p>	<p>We did not consider this to be a significant risk for Exeter City Council.</p>
<p><b>Management override of controls</b></p> <p>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>We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk, which was one of the most significant assessed risks of material misstatement.</p>	<p>We :</p> <ul style="list-style-type: none"> <li>• evaluated the design effectiveness of management controls over journals</li> <li>• analysed the journals listing and determined the criteria for selecting high risk unusual journals</li> <li>• tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration</li> <li>• completed our understanding of the accounting estimates and critical judgements applied made by management and considered their reasonableness with regard to corroborative evidence</li> <li>• evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.</li> </ul>	<p>Our audit work did not identify any issues in respect of the management override of controls.</p>

# Audit of the Financial Statements

## Significant Audit Risks - continued

These are the 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><b>Group Accounts</b></p> <p>At the time our audit plan was produced, the Council considered it likely that it would need to prepare group financial statements that consolidate the financial information of Exeter City Living Limited (ECL) as it considered the company was material to the City Council. This would be the first time that group accounts needed to be prepared by Exeter City Council.</p> <p>The Council subsequently confirmed its view that Group accounts would be required.</p>	<p>We reviewed:</p> <ul style="list-style-type: none"> <li>• the key agreements to gain an understanding of the arrangements put in place on the establishment of the company</li> <li>• the level and nature of transactions of Exeter City Living Limited (ECL) in 2018/19</li> <li>• management's assessment regarding the requirement for group accounts</li> </ul>	<p>We agreed that group accounts were required in 2018/19.</p> <p>We determined the scope of the work required in 2018/19 taking into account the opinion issued by ECL's External Auditor and the findings from their work.</p> <p>We did not identify any issues in respect of management's consideration of the need for group accounts and we obtained sufficient assurance over the key figures in the Company's financial statements</p>
<p><b>Valuation of land and buildings</b></p> <p>The Authority revalues its land and buildings on a rolling five-yearly basis. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved (c. £390 million at 31 March 2018) and the sensitivity of this estimate to changes in key assumptions.</p> <p>Additionally, management will need to ensure the carrying value in the Authority's financial statements is not materially different from the current value or the fair value (for surplus assets) at the financial statements date..</p>	<p>We :</p> <ul style="list-style-type: none"> <li>• evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work</li> <li>• evaluated the competence, capabilities and objectivity of the valuation expert and wrote to the valuer to confirm the basis on which the valuation was carried out</li> <li>• challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding</li> <li>• tested revaluations made during the year to see if they had been correctly reflected in the Council's asset register and financial statements</li> <li>• met with the valuer and reviewed a sample of revaluations in detail.</li> </ul>	<p>We did not identify any issues in relation to the valuation of land and buildings although we made recommendations regarding the revaluation of assets outside the formal rolling programme of revaluations to ensure that the balance is materially correct.</p>

# Audit of the Financial Statements

## Significant Audit Risks - continued

These are the 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><b>Valuation of the pension fund net liability</b></p> <p>The Authority's pension fund net liability represents a significant estimate in the financial statements.</p> <p>The pension fund net liability is considered a significant estimate due to the size of the numbers involved (£114 million in the Authority's balance sheet at 31 March 2018) and the sensitivity of the estimate to changes in key assumptions.</p> <p>We therefore identified valuation of the Authority's pension fund net liability as a significant risk, which was one of the most significant assessed risks of material misstatement.</p>	<p>We:</p> <ul style="list-style-type: none"> <li>updated our understanding of the processes and controls to ensure that the Council's pension fund net liability is not materially misstated and evaluated the design of the associated controls</li> <li>evaluated the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work</li> <li>assessed the competence, capabilities and objectivity of the actuary who carried out the Council's pension fund valuation</li> <li>assessed the accuracy and completeness of the information provided by the Council to the actuary to estimate the liability</li> <li>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</li> <li>undertook 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</li> <li>obtained assurance from the auditors of the Devon Pension Fund as to the controls surrounding the validity and accuracy of membership data; contributions data and benefits data sent to the actuary by the pension fund and the fund assets valuation in the pension fund financial statements.</li> </ul>	<p>The Council requested an estimate from its actuary of the potential impact of the McCloud ruling (see page 15 for an explanation of this). The actuary's estimate was of a possible increase in pension liabilities of £1.629m, and an increase in service costs for the 2019/20 year of £132k. The Council did not adjust its financial statements to reflect this additional liability.</p> <p>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> <p>We did not identify any other issues regarding the valuation of the pension fund net liability.</p>

# Audit of the Financial Statements

## Significant Audit Risks - continued

These are the 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><b>Operating expenses</b></p> <p>Our interim audit work identified that 80% of all service expenditure is procured without the use of purchase orders. It is possible that orders (and the committal of the Council to the expenditure) are therefore not authorised until the point that invoices are received for payment.</p> <p>We are working with Council officers to fully understand the deficiencies in purchasing authorisations. This is likely to have a significant impact on our testing strategy.</p>	<p>We:</p> <ul style="list-style-type: none"> <li>asked management to review the procurement process and identify any compensating controls that may be in place</li> <li>assessed the design and operational effectiveness of the Council's operating expenses system</li> </ul> <p>As all expenditure is approved before any payment is actually made, we concluded that there was no risk regarding the occurrence of expenditure in the year. However, there was a risk regarding the completeness of expenditure within the financial statements.</p> <p>We therefore designed our audit programme to reflect this additional risk and undertook extended testing of the controls in place and extended our cut-off sample to test to include the payments made in April, May and June 2019 to ensure they were accounted for in the correct financial year.</p>	<p>Our testing did not identify any issues regarding the completeness of expenditure.</p>

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# Audit of the Financial Statements

## **Audit opinion**

We gave an unqualified opinion on the group's financial statements on 31 January 2020.

## **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 and Governance Committee on 28 January 2020.

In addition to the significant audit risks reported above, we recommended that the Council should review the critical judgements disclosed in the 2019/20 financial statements to ensure that they are appropriate and do not have a material impact on the Council's accounts.

## **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 within 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.

## **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.

To date, we have not exercised any of our additional statutory powers or duties although, as reported on page 3, we have yet to resolve a matter raised by a member of the public.

## **Certificate of closure of the audit**

We are unable to certify that we have completed the audit of the financial statements of Exeter City Council until we resolve the matter raised by a member of the public relating to monies paid to a community organisation in 2018/19.

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# 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 January 2020, 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><b>Delivering a sustainable medium term financial plan</b></p> <p>The medium term financial plan showed that significant savings were required to achieve financial balance with the Council planning a use of its reserves in 2018/19 in order to achieve its budget.</p>	<p>We reviewed the Council's reserves and the plans in place to ensure an appropriate level of reserves is maintained.</p> <p>We assessed the arrangements in place to deliver financial savings in order to ensure they are realistic and deliverable.</p>	<p>The outturn for 2018/19 per the Council's financial statements showed that the General Fund balance reduced in the year by £296k (6% of the opening balance) to £4.691m, although this is still comfortably above the minimum level set by the Council of £3m. During 2018/19, the Council's earmarked reserves increased from £7.8m to £9.5m meaning that the Council's overall financial position strengthened in the year.</p> <p>Looking ahead, the Council approved its most recent medium term financial plan in February 2019 which covers the 2019/20 financial year and looks ahead to 2022/23.</p> <p>Whilst the funding available in the latter years is uncertain across the whole of Local Government, the Council's medium term financial plan shows that savings totalling approximately £2.5m will be required across that period, with a peak of almost £2m in 2019/20. The Council has developed plans to deliver the required savings in that year and it has the safety net of available reserves to cover any shortfall, although it recognises this is not sustainable into the long term and ultimately it needs to balance the books year on year.</p> <p>The Council has a good track record of delivering its savings targets and we concluded that whilst the Council faces a challenging financial position, there remain appropriate arrangements in place for managing the budget.</p>

# Value for Money conclusion

## Value for Money Risks (cont'd)

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>Governance of Exeter City Group Limited</b></p> <p>The Council established a significant subsidiary company in the year which is likely to have material transactions outside the Council's direct control.</p>	<p>We assessed the governance arrangements in place for the new company, including a review of the original business case.</p>	<p>The main purpose of the group is to build homes to help tackle housing need in Exeter, to help reduce the pressures on the Council's housing waiting list and to improve the lives of those residents currently living in poor quality homes. The Council provided a 25 year loan of £2.2m on 11 January 2019 in order to implement the Year 1 business plan to Exeter City Living Ltd and a further £2.15m loan was advanced in April 2019.</p> <p>Before the companies were formed there was considerable engagement with Members, with discussions at scrutiny, Executive and Full Council levels.</p> <p>The City Council also obtained independent legal advice regarding the establishment of the companies and has appointed its own external auditors.</p> <p>Based on our review of this area, the governance arrangements in place for the new company appear to be adequate.</p>

# Value for Money conclusion

## Value for Money Risks (cont'd)

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>The re-development of the bus station and surrounding area</b></p> <p>This is a significant project over two years and the capital programme will need to be managed effectively if it is to deliver the expected benefits on time and within budget.</p>	<p>We assessed the arrangements and information provided to enable the Council to make an informed decision and the capital monitoring arrangements to ensure the project is delivered on time and to budget.</p>	<p>The Council has established a Sub-Committee of the Executive (the Leisure Complex and Bus Station Programme Board) to monitor progress on this significant project for the Council, which has a budget of over £50m. The Board includes seven Members of the City Council to ensure it is politically balanced.</p> <p>The Board has been meeting since July 2015 and meets every three to four months and its terms of reference were agreed at the first meeting.</p> <p>We noted the regular engagement by the Council's Chief Executive &amp; Growth Director and the fact that key decisions go through the Programme Board, Executive and then to Full Council.</p> <p>The latest monitoring report we reviewed (as at 19 August 2019) stated that progress was currently as planned and that the budget was on track.</p> <p>Based on our review of this area, the decision making arrangements in place for the new development appear to be adequate.</p>

# Value for Money conclusion

## Value for Money Risks (cont'd)

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>Procurement: follow-up work</b></p> <p>The Council's previous auditors reviewed the progress made by the Authority against its procurement action plan and concluded that although there had been some progress, the timing of these improvements and the need still for additional progress to be made meant that they were unable to conclude that sufficient improvement has been achieved in strengthening the Authority's procurement arrangements. They therefore issued an 'except for' qualification in 2017/18 for a third year.</p>	<p>We followed up on the progress made by on the issues raised by the Council's previous auditors regarding the Council's procurement processes.</p>	<p>The Council was unable to provide us with an action plan setting out the way in which it had responded to the previous recommendations.</p> <p>We therefore undertook an overview of the procurement arrangements in place at the Council and found that:</p> <ul style="list-style-type: none"> <li>• The Council has updated its procurement and contract procedures and now has appropriate procedures in place.</li> <li>• Training has been rolled out to all those officers involved in procurement to ensure they are aware of the new procedures and why they should be adhered to;</li> <li>• The Council has reviewed and retendered its large contracts as appropriate, so that the majority are now compliant with its procurement and contract procedures.</li> </ul> <p>The Council's Internal Auditors have completed a recent review of the procurement arrangements and they concluded that they provided 'satisfactory assurance'. Internal Audit made a number of recommendations, but none were assessed by them as being 'high risk'.</p> <p>We have concluded that sufficient progress has been made to conclude that adequate arrangements are in place. However, the Council should continue to embed effective procurement arrangements and should develop an action plan against which progress and remedial action can be taken as required. Progress against Internal Audit's recommendations should be monitored.</p>

# A. Reports issued and fees

We confirm below our final fees charged for the audit and provision of non-audit services in 2018/19. Fee variations are subject to PSAA approval.

## Reports issued

Report	Date issued
Audit Plan	February 2019
Audit Findings Report	September 2019 (interim) January 2020 (final)
Annual Audit Letter	February 2020

## Fees

	Planned fees £	Actual fees £	2017/18 fees £
Statutory audit	44,573	51,523	57,887
Housing Benefit Grant Certification	17,298	17,298	15,270
<b>Non audit services</b>			
Pooled Capital Receipts Return Certification	3,000	3,000	3,000
<b>Total fees</b>	<b>£64,871</b>	<b>£71,821</b>	<b>£76,157</b>

## Audit fee variation

As outlined in our audit plan, the 2018-19 scale fee published by PSAA of £44,573 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 table overleaf.

## Non- audit services

- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the group. The table opposite 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 group's auditor and have ensured that appropriate safeguards are put in place.

The non-audit services are consistent with the group's policy on the allotment of non-audit work to your auditor.

# A. Reports issued and fees

## Audit fee variation

The following fee variations are subject to PSAA approval

Area	Reason	Fee proposed
<b>Assessing the impact of the McCloud ruling</b>	The Government's transitional arrangements for pensions were ruled discriminatory by the Court of Appeal in December 2018. The Supreme Court refused the Government's application to appeal this ruling. We have reviewed the revised actuarial assessment of the impact on the financial statements along with any audit reporting requirements.	1,500
<b>Pensions – IAS 19</b>	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. We have increased the level of scope and coverage in respect of IAS 19 this year to reflect this.	1,500
<b>PPE Valuation – work of experts</b>	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
<b>Group Accounts</b>	Since the original fee was determined by Public Sector Audit Appointments, the Council has needed to produce group accounts for the first time and this required additional audit work.	1,500
<b>Harbour Accounts</b>	We have agreed a separate Letter of Engagement and are required to issue a separate opinion on the Council's Harbour Accounts.	950
<b>Total</b>		6,950



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