
Subject: SECTION 151 OFFICER'S RESPONSE TO THE AUDITOR'S ANNUAL REPORT

Meeting and Date: Governance 28th March 2024

Report of: Mike Davis, Strategic Director (Finance and Housing)

Portfolio Holder: Councillor Sue Beer, Portfolio Holder for Finance, Governance, Climate Change & Environment

Purpose of the report: To present members with a response and update to the Auditor's Annual Report included separately on the agenda.

Recommendations: That members note this report.
That the committee ratifies the approach agreed with the external auditor to disclaim the outstanding historic accounts in accordance with the Department for Levelling Up, Housing and Community's proposed backstop date of 30th September 2024.

1. Summary

1.1 The Auditor's Annual Report for financial years 2021/22 and 2022/23 is included elsewhere on the agenda. The report covers the auditor's view on the Council's arrangements for securing economy, efficiency, and effectiveness in its use of resources, assessing the arrangements under:

- Financial sustainability,
- Governance, and
- Improving economy, efficiency, and effectiveness.

1.2 The auditor's view focuses significantly on the challenges faced by the council over that period, mainly relating to the issues with the implementation of the new financial system.

1.3 We welcome the report from the auditors and understand their position as presented, however it is our view that further understanding and context is required to aid members' understanding of the overall position. This report is therefore provided to give the committee that context and information relating to the report and the outcomes identified within it.

2. Overview

2.1 The period covered by the auditor's report was a challenging period for all councils. Officers have been working with a number of significant pressures including:

- Impact of the pandemic and lockdowns,
- Numerous complex and burdensome grant regimes during and after Covid,
- Staff turnover and recruitment difficulties,
- Implementing a new system,
- The effective collapse of local audit with all auditor companies (including Grant Thornton) having delays with virtually all their clients - DDC is not an outlier,
- The collapse of the local government finance / settlement system with the whole sectors showing extreme financial stress.

- 2.2 It is important to note that the normal budget process has continued during the audited period and that the budgets have been set with confidence in the figures held on the financial management system. The council has never lost control or understanding of its financial position. Page 16 of the auditor's report recognises the financial awareness of the corporate management team (CMT) and their actions to manage the challenges and their approach to future funding challenges.
- 2.3 The auditor report does not consider comparisons with our neighbouring authorities. Members should be aware that Dover District Council (DDC) is similar in most respects to Folkestone & Hythe District Council (FHDC), but that the FHDC council charge is 30% higher than that charged by DDC, resulting in an additional £2.6m income per year for FHDC. The table below illustrates the comparison with all East Kent authorities:

	Band D Council Tax £	Difference to DDC %	Extra Income DDC would receive
Dover District Council	208.17	-	-
Canterbury City Council	232.92	11.89%	£989k
Folkestone and Hythe District Council	272.07	30.70%	£2.6m
Thanet District Council	255.54	22.76%	£1.9m

- 2.4 This report initially covers the key areas identified above and then provides more detail on the specific areas covered in the report.

3. Financial Sustainability

- 3.1 The Auditor's Report focuses on the financial management processes during 2021/22 and 2022/23 and their concerns around the effectiveness of the financial management system.
- 3.2 In practice the system was still able to produce reliable budget estimates, provide budget monitoring information for managers and produce the information for understanding the council's outturn position for those years.
- 3.3 The 2021/22 outturn provided an additional £1.2m contribution to reserves and the 2022/23 outturn resulted in a £27k underspend for the year. The council's reserve levels were maintained at a healthy level during the period and the council was able to set balanced budgets during a particularly challenging economic climate.
- 3.4 The biggest risks to the council's financial sustainability come from the uncertainties featured in the Section 25 report that accompanied the 2024/25 budget papers to Cabinet and Council. The section 25 report raised a number of concerns regarding the operation of the Department of Levelling Up, Housing and Communities (DLUHC) and the Department for the Environment and Rural Affairs (DEFRA). The auditor's report does not recognise that without a reasonable local government settlement and responsible behaviour by DEFRA, resolution of the resulting financial pressures and extreme stress will require major service reductions to address.
- 3.5 Other pressures facing the council include pressures from homelessness and the "cost shunt" arising from KCC (Kent County Council) as supported housing costs are transferred from KCC to the council.

- 3.6 It is these national issues that are why councils which have behaved reasonably in the past are now issuing, or at risk of issuing, section 114 notices.
- 3.7 The 2024/25 budget, excluding the Port Health pressures is balanced with no major changes to services proposed. This is key for members to note when considering the financial sustainability of the council.

4. Governance

- 4.1 We welcome the recognition that the culture around decision making is sound and that the auditors' attendance at a CMT meeting confirmed that there is a "shared and appropriate level of accountability for all matters finance from the whole of CMT".
- 4.2 The report also recognises the effectiveness of the internal audit function, and that risk management is being effectively managed with regular reviews of risk being undertaken at all levels across the organisation.
- 4.3 The recommendations raised for the governance section relate to project management across the council, the CIPFA recommendation for independent members of the Governance Committee and attendance levels by the committee members during the period of the report.
- 4.4 Progress has been made on the management of corporate projects with digital projects now being supported by project managers within the digital services team and regularly reporting to corporate management team of the council's major projects. The project management process is under review and updated proposals are planned to be presented to CMT in the new financial year.

5. Improving Economy, Efficiency and Effectiveness

- 5.1 We welcome the acknowledgement that the council has adequate arrangements in place to deliver economy, efficiency, and effectiveness. This includes recognising the successful return of East Kent Housing to an in-house service, the up-to-date procurement strategy, and effective partnership working.

6. Background – National Context

- 6.1 The impact of the Covid-19 pandemic lockdowns and a general shortage of resources in the local authority audit sector have led to significant backlogs in the audit sector which is now in chaos (on 30 September 2023 there were 918 outstanding audits, and 771 as at 31 December 2023).
- 6.2 Despite attempts across the sectors to catch up this has become unmanageable and solutions to resolve the issues have been considered.
- 6.3 Recently the Department for Levelling Up, Housing and Communities (DLUHC) started a consultation to find possible solutions to the backlog of published audited accounts for local authorities and is proposing putting a date in law (the "backstop date") of 30 September 2024 by which point local bodies would publish audited accounts for all outstanding years up to and including 2022/23.

6.4 Dover District Council has 3 years of accounts not yet complete and audited:

- 2020/21 published, audit started not completed,
- 2021/22 not yet published,
- 2022/23 not yet published.

6.5 This position is not uncommon across the sector, less than 10% of audits of local authorities' financial statements had been submitted for the financial year 2022-23 by December. Before the pandemic in 2018, 87% of audits were completed by the then publishing deadline of 31 July and Dover's accounts were published, audited and up to date.

7. **Background – Production of Accounts**

7.1 When the national lockdowns took effect many of the Accountancy team were allocated to support the Community Hub workstreams to support our communities during these challenging times. This work was considered a priority due to the urgent nature of providing residents with appropriate care and support, arranging for the vulnerable in the district to be equipped with food, medicine and support.

7.2 Alongside this the financial pressures on the council started to take effect, with significant impacts on the major income streams (parking, leisure, council tax, business rates, etc.), cost pressures increasing (homelessness, ICT investment, leisure support, etc.) and delays to and the reprioritisation of the capital program needing to be incorporated into the budget processes.

7.3 These significant impacts resulted in additional monitoring and reporting to Cabinet and Council to restate the 2020/21 budget creating further pressures and delays on the finalisation of the 2019/20 Statement of Accounts.

7.4 The audit of the 2019/20 accounts started in January 2021 and in July 2021 the draft position was presented to Governance committee as, at that time, the audit was considered to be nearly completed with only a few final adjustments required. However, further delays were incurred and the final approval of the 2019/20 accounts did not take place until December 2022.

7.5 In the interim period the 2020/21 accounts and outturn position were worked on and drafted. These were impacted by the delays to 2019/20 and were published in August 2022.

7.6 The audit for the 2020/21 statement started in January 2023 but was unable to be completed before the auditors were required to start their NHS audit work in April 2023. As detailed in the auditor's report, this audit remains unfinished, and it is now proposed that the accounts for 2020/21 are disclaimed in line with the DLUHC consultation to address the backlog.

7.7 The time taken on the 2019/20 and 2020/21 audit processes has had a significant impact on capacity in the finance team. This has been aggravated by the staffing challenges faced by Grant Thornton, including inexperienced audit staff, use of overseas staff and significant staff turnover. Due to the extended periods of the audits, there have been areas reopened and reviewed multiple times, responses to queries lost, duplicate queries raised, etc. especially when handovers between staff have taken place. These all created additional capacity pressures on the team.

- 7.8 For both 2021/22 and 2022/23 financial years reconciliations and checks were undertaken to identify and report the outturn positions for the years. However, due to the incomplete prior year audits the statement of accounts were not finalised due to the uncertainty around the prior year audits and the potential changes to the opening balances throughout the technical document.
- 7.9 Relevant disclosures were added to the website to advise of the delays to the audit processes and production of the impacted years statements and the portfolio holder was kept briefed on the position at the regular update meetings.

8. **Current Position – Production of Accounts**

- 8.1 At the beginning of the year additional temporary resource was recruited to solely focus on publishing the outstanding statements of accounts. They have worked through all the audit queries raised on the 2020/21 accounts, provided responses to the outstanding audit queries (excluding bank reconciliation as detailed below) and updated the statement of accounts for the audit queries identified.
- 8.2 It is important to note that the changes identified by the audit process were mainly technical adjustments, with the only material changes relating to the valuation of some of major assets including the Dover District Leisure Centre and the Dover Town Hall (Maison Dieu). These material changes did not impact the council's underlying financial position relating to its budgets, reserves on on-going financial stability.
- 8.3 Some minor changes were identified relating to our treatment of minimum revenue provision due to a technical accounting change. This was reviewed with our treasury management advisors, their recommended changes applied to the 2020/21 financial year, and these have been built into future budgets.
- 8.4 As detailed in the auditor's papers we have discussed with the auditors whether the 2020/21 can be successfully concluded ahead of the September backstop date. They anticipate that a further 6-8 weeks work is required to complete the audit and proposed that this would be undertaken in April. It is not considered that this would be an effective use of officer resource or that the additional costs from the audit team would represent value for money. It is also a concern that taking finance resource away from the production of the 2023/24 accounts process will impact the ability of the team to complete the process by the 31st May deadline and result in a ripple effect of delays to future years.
- 8.5 It is therefore proposed that, subject to ratification by the Governance Committee, the auditors will issue a disclaimer opinion for the 2020/21 accounts.
- 8.6 The revised statement of accounts, incorporating the required changes from the 2020/21 audit process, have now been published on the website.
- 8.7 The completion of the revised 2020/21 accounts has provided clarity on the 2021/22 opening balances and therefore allowed work to be resumed to finalise the statement for the year. This work is well underway, and it is anticipated that an unaudited statement of accounts for 2021/22 will be published shortly.
- 8.8 Work to finalise the 2022/23 accounts will progress as soon as the 2021/22 accounts are published, and it is the aim to complete these early in April to then be able to produce a complete set of 2023/24 accounts by the 31st May deadline.

8.9 An update on progress will be presented to the Governance Committee at the June meeting.

9. **Background – Financial Management System**

9.1 The Council approved the implementation of a new financial system in March 2019. The previous system had been in place since 2001 and was working alongside an in-house built budget system. The existing system had incurred significant increases in price with minimal development of the system and the in-house system was no longer supportable due to the loss of expertise resulting in the lack of ability to maintain and develop it.

9.2 The implementation process started in 2019 with a target go-live date of June 2020. Two officers were seconded full time to the project to lead the implementation. The project was progressing well when the national lockdowns for Covid-19 took effect requiring all staff to move to full time working at home.

9.3 In the summer of 2020 one of the seconded officers decided to leave the team to take up a promotion opportunity at a different council. This left a shortfall in the resources available to finalise the project and the decision was made to postpone the go-live date to October 2020. Resource from Internal Audit was allocated to the project to assist with the project management and overseeing of the final stages of implementation.

9.4 In September 2020 it was agreed to progress with the go-live date of October taking into account the upcoming expiry of the existing system contract, the progress made on the implementation and the preference to not postpone the implementation to a date that would then run across a year end process.

9.5 The implementation and switchover took place in October 2020. Unfortunately, the impact of the loss of the project lead, other key staff, and with the majority of the team still working at home under lockdown regulations, made the transfer of skills and training very challenging and impacted timescales available for the team to finalise the 2019/20 accounts alongside the setting of the 2021/22 budget setting process.

10. **Current Position – Financial Management System**

10.1 As detailed in the auditor's report there have been a number of issues identified with the new financial management system since its implementation. Many functions of the system progressed unaffected including raising purchase orders, paying suppliers, and viewing budget information.

10.2 Initially resources were focused on maintaining business as usual with the setting of budgets, monitoring of budgets and completion of the year end outturn positions. Training of the team was challenging due to the on-going working from home and lockdown requirements but, nonetheless, the budgets following the implementation have all been completed and approved in accordance with the statutory timetables.

- 10.3 Since implementation further issues have been identified, the most significant areas being the automated bank reconciliation process and the ability to submit digital VAT claims, as detailed in the report.
- 10.4 The report expresses a concern that members were not kept informed and so resources were not allocated to support the recovery of the issues quickly enough. The portfolio holder at the time was kept informed of issues during the regular briefings held and, initially, the team tried to manage with the existing resources available, this became unsustainable due to the staffing changes faced within the team and additional support was brought in to resolve the outstanding work.

Bank Reconciliation

- 10.5 It is important to note that the council is fully aware of the balances held in its bank accounts and investments. The concerns raised relate only to the technical ability to be able to reconcile the bank statement positions to the data held on the financial management system. The differences mainly relate to the allocation of transactions between bank "accounts" on the financial ledger and adjustments made for inter account transfers and the ability to match numerous individual ledger transactions to corresponding lump sum statement entries manually.
- 10.6 Initially interim administrative support was provided for the team to undertake the bank reconciliation process manually but due to the quantity of transactions being processed through this was unmanageable and resulted in further difficulties as any transactions matched in error could not be unmatched and corrected.
- 10.7 It was agreed for the system provider to reset the bank data and restart the process from scratch. Since then, the accountancy and income teams have been working closely together to review the detailed processes and understand the nature of the different streams of data interfacing with the financial management system. The 2020/21 data has been thoroughly reviewed and reconciled up to the end of the financial year, with the transactions to be queried and year end outstanding data, to be reconciled to be matched in 2021/22. Accountancy resources are prioritising the completion of the 2020/21 reconciliation and aim to complete it early in the new financial year.
- 10.8 Through the detailed review of the processes, it is anticipated that the subsequent years will get easier to reconcile, as the data narration improves, and matching is more straightforward. The completion of the outstanding years will be prioritised after the production of the 2023/24 accounts.
- 10.9 The recent approval of the new Enterprise Cash Receipting system will further reduce differences in the future as all transactions will happen directly in the financial management system and therefore reduce the need for checks and interfaces from feeder systems. At this time, it should be possible to implement auto matching of statement and ledger transactions. Data integrity will also be improved as receipts are matched to internal references at the point of payment, removing the need for manual intervention.

VAT Returns

- 10.10 The implementation of Making Tax Digital required organisations to keep digital records and file their tax returns using compatible software. No interventions via spreadsheets or other formats are permitted. This means that the data held on the

financial management system must be accurate, with the correct VAT category applied to all transactions.

- 10.11 Issues with the interfaces between the income management systems and the financial management system were identified where the VAT treatment was being amended between the source information and the general ledger information. This has led to a line by line / transaction by transaction review of VAT treatment being required to be confident that the data submitted to HMRC (HM Revenue and Customs) is accurate. In addition to this, it was noticed towards the end of 2022-23 that the tax returns were not picking up exempt transactions on Technology One. This was due to the rate code table being set up incorrectly at implementation. As a result, the transactions had to be reversed and re-entered by journal to correct the transaction settings. They would then correctly appear on the VAT return as exempt transactions.
- 10.12 In January 2023, an upgrade to the income management system was required and the opportunity was taken to thoroughly check and review the VAT categories included on the system and to test the effectiveness of the new interfaces to reduce the errors being incurred.
- 10.13 External support was recruited in Autumn 2023, and they have been undertaking the review, identifying changes and corrections, and preparing the changes for input onto the system for the completion of the VAT returns. VAT returns up to September 2022 have now been completed submitted to HMRC. The review of the remaining 2022/23 data is also complete with the final checks and changes being made by the Accountancy team it is anticipated that the VAT returns for the 2022/23 financial year will be completed early in the new financial new year.
- 10.14 Alongside the review of transactions, the external support has created spreadsheets and processes to automate the checking of transactions to streamline the process moving forwards. They are now training and supporting an existing team member to enable them to take the checking process and keep the returns up to date for the future.
- 10.15 The change to the income management system appears to have been successful and the review of the 2023/24 data is expected to be more straightforward with less corrections required before submission of each monthly return. This may be further simplified when income management is transferred onto the main financial management system.

11. **Other Factors**

- 11.1 There have been several staffing changes since the pandemic, with key members of the accountancy team moving on and leaving vacancies. Backfilling those vacancies has been very challenging with a significant shortfall in experienced local authority finance staff looking to move into new roles. This has been exasperated by the growing temporary and contract market with many experienced local authority accountants moving into a more flexible working arrangement through agency providers.
- 11.2 Due to these challenges the Accountancy team had not been at full capacity since the pandemic, and it is only recently that all vacancies have been filled and the team is fully resourced.

- 11.3 It is also important to note that the transfer of East Kent Housing back to the council occurred during 2020 and required significant finance input to the project workstreams to support delivery of the transfer.
- 11.4 Additionally, new government schemes and funding during the pandemic were accompanied by additional, complex reporting requirements, creating a significant resource burden on the team in claiming, monitoring, and reporting on these grants and schemes.
- 11.5 Finally, the overall format and usefulness of the accounts remains a significant issue in the local authority sector. The statutory format does not support the transparency agenda and is not easy to read or understand by members or the public. The government continue to require reporting in accordance with International Financial Reporting Standards (IFRS), despite pressure from the sector to recognise that local authority accounts will never be comparable to commercial accounts.
- 11.6 The CIPFA (Chartered Institute of Public Finance and Accountancy) code and guidance continues to reflect the IFRS requirements, and the Financial Reporting Council (FRC) are heavy handed in enforcing its application with the auditors. The auditors spend significant amounts of time responding to the FRC, time that could be better spent working with councils on the audit process.
- 11.7 Ultimately, the main outcome from producing and auditing the statements of accounts is that they are technically correct, but, as standalone documents, they are of very limited use to the public and members.

12. **Background Papers**

2019/20 Statement of Accounts – Governance Committee 1st December 2022

2024/25 Budget and Medium Term Financial Plan – Council 6th March 2024

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