

South Hams District Council Guidance for audit committee members when reviewing the financial statements

Year ending 31 March 2022

May 2022



Guidance for audit committee members

This paper sets out a series of questions that members could ask at audit committee meetings to assess how things are going and to identify any areas of potential concern. Good governance involves members challenging appropriately financial reports during the year and at the year-end – it is important that they feel able to ask questions and understand why they are asking them. Although some of the questions relate primarily to the annual accounts, they could also be used when reviewing the monthly or quarterly financial position.

The questions are grouped under six headings, namely:

- overall performance;
- accounts preparation;
- comprehensive income and expenditure statement;
- movement in reserves statement;
- balance sheet; and
- cash flow statement.

The briefing is not intended to be exhaustive in its coverage – instead it focuses on key questions that may be helpful and relevant when discussing different aspects of financial performance and the Council's accounts.

Guidance for audit committee members

Overall performance

Question	Underlying reasoning
Are the accounting policies consistent with what you know the organisation does in practice?	Accounting policies must be tailored to reflect local circumstances.
Do the accounts include disclosures relating to: <ul style="list-style-type: none"> • judgements made when applying key accounting policies; and • areas where there is uncertainty about the estimates used 	Do these disclosures reflect your understanding? Have these issues been raised by auditors? Are there issues that auditors have raised in previous years which are not reflected in the accounts?
Do the accounts include a disclosure on going concern?	LG bodies prepare their accounts on a going concern basis. However, disclosures are required on managements' assessment of going concern and any uncertainties relating to that status. This disclosure should reflect any concerns about the financial position or cash flows of the LG body.

Guidance for audit committee members

Overall performance

Question	Underlying reasoning
Can you see the impact of any savings schemes during the year? These schemes may include a reduction in headcount, income generation or changes to procurement? How are savings managed?	This is to check whether known changes have been reflected. Successful savings schemes should be reflected in the accounts – for example, reductions in headcount should result in reduced staff costs.
Are the financial assumptions consistent with the organisation's annual plan and previous financial information provided?	If in-year forecasting and reporting is accurate, there should not be any surprises at the year end: the year-end accounts should reconcile to the in-year financial reports. If there are any inconsistencies, can they be explained?
Have there been any significant issues raised with the audit committee during the year? - for example, significant weaknesses in systems, or variances between planned and actual activity, that could cast doubts on the assumptions made?	If there is any potential missing information or doubts over assumptions, have these been explained?

Guidance for audit committee members

Overall performance

Question	Underlying reasoning
Have the annual governance statement and head of internal audit opinion recorded any internal control issues?	A key part of the year-end process, the Section 151 officer must review the system of internal control and whether or not the organisation has faced any significant control issues – for example, serious incidents. Do these disclosures reflect your understanding? Have any issues raised the previous year been resolved? Are milestones in place for outstanding issues?

Guidance for audit committee members

Accounts preparation

Question	Underlying reasoning
<p>Do the financial statements as a whole (and as part of the annual report and accounts) focus on the important issues and highlight the key financial issues for the LG body?</p>	<p>Some disclosures in the financial statements are required by accounting standards. However, there is an initiative within financial reporting to ‘cut the clutter’ which means taking out immaterial disclosures, zero rows and columns to help the reader of the accounts identify what is important. Taking a step back, think about whether the accounts, as a whole, reflect your understanding of the financial position of your organisation.</p>
<p>What is the level of adjustments via manual journals?</p>	<p>Journals are used by the finance team to adjust the amounts in the ledger. This is normal financial management. However, LG bodies that encounter financial difficulties may report large/ material journals that adjust the financial position and cannot be adequately explained on deeper investigation.</p>

Guidance for audit committee members

Accounts preparation

Question	Underlying reasoning
Do you understand and agree with any judgements/ estimates that have a material impact on the financial statements?	There are always areas of judgment/ estimation when preparing the accounts. For example, in considering the level of provisions that should be established; the basis of valuation of non-current financial assets; write-off of receivables. These should be consistent with your understanding of the organisation and its wider policies/ strategies.

Guidance for audit committee members

Statement of comprehensive income and expenditure

Question	Underlying reasoning
How have the figures changed compared to last year and the year before that? Are any changes expected/unexpected?	For changes that you were expecting, do the figures look right? If no changes were anticipated, you would generally expect figures to increase with inflation. If there are movements that are much larger than this, you should find out why. Any unexpected changes need to be identified and explained.
Do the figures seem reasonable and complete, including those entries that are zero?	Is any information missing? If it is, do you know the reason?
Is the surplus/ deficit consistent with the forecasts made during the year?	If in-year forecasting is accurate, there should not be any surprises at the year end. If there is a significant change, can it be explained?
Has there been a prior period adjustment?	Is this due to a change in accounting policy that should be reflected in the opening note to the accounts, or another reason?
Do you know what expenditure has been included in 'other' categories?	Expenditure is expected to fall into specified categories in most cases. If it is included in 'other', do you know what this is and understand why it does not fit with any of the specified categories?

Guidance for audit committee members

Statement of comprehensive income and expenditure

Question	Underlying reasoning
What has caused changes in pay expenditure?	How much of the change relates to pay awards? What has been the impact of agency? Which areas of staff expenditure are increasing? Does any movement in staff costs correspond to the change in staff numbers?
To the best of your knowledge, does the disclosure in relation to remuneration of senior employees appear complete?	Do the figures reflect your knowledge of directors in position during the year and any changes? Do the amounts disclosed reflect your understanding of the amounts paid to each individual?
Do the income figures appear reasonable and can officers explain the reasons for any changes from the previous year?	A wider understanding of what income is expected can flag potential areas of omission or where further review is needed.

Guidance for audit committee members

Statement of comprehensive income and expenditure

Question	Underlying reasoning
Do the expenditure figures appear reasonable and can officers explain the reasons for any significant changes from the previous year? For example, do you know what services you now buy from another organisation that you did not buy last year?	A wider understanding of what expenditure is expected can flag potential areas of omission or where further review is needed.
Is there a meaningful change in the depreciation figure in the statements?	Has the organisation changed the useful economic lives of its assets (this should be reflected in the accounting policies noted above). If so, is this change appropriate?

Guidance for audit committee members

Statement of comprehensive income and expenditure

Question	Underlying reasoning
<p>If there has been an impairment (loss in asset value), do you know why? Does the property, plant and equipment note to the accounts reflect the situation accurately and clearly?</p>	<p>Assets lose value due to changes in the economic climate and damage/ obsolescence. Is any change reasonable based on your knowledge of the organisation and the prevailing economic climate?</p>
<p>Can officers explain the reasons for any significant changes in leasing costs and/ or commitments?</p>	<p>Have any material leases been signed during the year or have any come to an end? A wider understanding of what lease changes are expected can flag potential areas of omission or area for further review.</p>

Guidance for audit committee members

Movement in reserves statement

Question	Underlying reasoning
Do the lines that should net to zero do so when added together? Lines which net to zero are transfers between reserves.	Do you understand the reason for any transfer? Looking at the lines may identify any omissions or amendments elsewhere in the accounts that have not tracked through.
Has there been a prior period adjustment?	Is this due to a change in accounting policy that should be reflected in the opening note to the accounts, or another reason?
Are there any significant changes to the revaluation reserve? (See also the questions on non-current assets under the statement of financial position.)	Have these been explained and does the reason fit with what you know? Are revaluations based on appropriate assumptions? Have those assumptions been discussed and reviewed by the audit committee?

Guidance for audit committee members

Balance sheet

Question	Underlying reasoning
Have any items changed significantly since last year?	Do any changes fit with your knowledge of the organisation's activities? Use the note references to find out more detail about any items that look unusual.
Non-current assets (property, plant and equipment)	
Does the movement in the valuation of property, plant and equipment agree to the revaluations and impairments of these assets and are they what you expect?	Assets lose value due to changes in the economic climate and damage/ obsolescence. Is any change reasonable based on your knowledge of the organisation and the prevailing economic climate? Assets can increase in value due to changes in the property market or changes in the building trade - for example, the price of building materials.
Do non-current asset additions and disposals tie in with your knowledge of the organisation's capital programme?	A wider understanding of asset movements expected can flag potential areas of omission or further investigation. The level of additions and disposals should tie in with your understanding of the capital programme and estates management plans.

Guidance for audit committee members

Balance sheet

Question	Underlying reasoning
Has there been a professional valuation of the property this year?	There is no requirement to have an annual valuation but the asset values must be materially correct. Do you understand your organisation's policy on valuation?
Has the valuer used or the valuation basis changed?	The valuation of property requires judgments, assumptions and estimates to be made. Different valuers make different judgements. Do you understand the reasons for the judgements/ estimates made and do they make sense in relation to the body's capital programme and overall strategy?
Do movements in property, plant and equipment agree with your understanding of the capital programme?	Can any movement in property, plant and equipment be explained by asset disposals or acquisitions?
Has there been a loss on the disposal or sale of an asset? Was this expected?	Any disposals should be part of the wider capital programme. It is worth asking why there was a loss on disposal. A wider understanding of expected asset movements can flag potential areas of omission or error.

Guidance for audit committee members

Balance sheet

Question	Underlying reasoning
<p>Has there been a reclassification out of assets under construction into property, plant and equipment – does the organisation have a new building that has just become operational?</p>	<p>This should be part of the capital programme. Once an asset is operational, the costs related to that asset (depreciation, maintenance and so on) should be included in financial plans and forecasts. A wider understanding of expected asset movements can flag potential areas of omission or error.</p>
<p>Non-current/ current assets</p>	
<p>Are receivables growing? Does the organisation have more money tied up in debtors? Is there an effective debt recovery process?</p>	<p>What are the underlying reasons? Is there a prompt payment policy? The longer debts take to be paid, the greater the pressure on the organisation's cash flow.</p>
<p>Are there any particularly large receivables this year, or significant changes from the prior year? Can officers explain the reasons for these?</p>	<p>When reviewing receivables, it is important to consider the 'collectability' of balances. If receivables increase, what is the effect on aged debtors and debtor days? Any unexpected or unexplained large movements may highlight an area for further review.</p>

Guidance for audit committee members

Balance sheet

Question	Underlying reasoning
Can officers explain the level of bad debts that have been provided for and written off?	Bad debt provision is a judgement – are the assumptions used in calculating this in line with expectations?
Does the provision for impairment of receivables look reasonable?	Provisions are based on judgement – are the assumptions used in calculating this in line with expectations?
Have prepayments only been made to organisations that have sound financial standing and where the organisation gains value from the prepayment?	Public sector bodies generally should not make payments in advance of receiving goods or services. Such payments should only be made to achieve value for money. The risk that the goods/ services may not be delivered should be recognised and a mitigation strategy put in place. The organisation’s cash flow should also be protected.

Guidance for audit committee members

Balance sheet

Question	Underlying reasoning
Non-current/ current liabilities	
Have trade payables (creditors) grown? How much money does the Council owe its suppliers?	If this is increasing, the organisation may be experiencing cash flow problems and delaying payment to creditors to manage its cash position.
Are there any particularly large trade or other payables this year, or significant changes from the prior year? Can officers explain the reasons for these?	An increase in payables may indicate cash flow problems. Any unexpected or unexplained large movements may highlight an area for further review.

Guidance for audit committee members

Balance sheet

Question	Underlying reasoning
<p>Can officers explain significant receipts in advance and deferred income?</p>	<p>Public sector bodies generally should not make payments in advance of receiving goods or services. Have the services/ goods that have already been paid for been taken into account in forecasts? What is the reason for the deferral? If there is a judgement required, has it been discussed and agreed with both the third party involved and auditors?</p> <p>Receipts in advance and deferred income require agreement with the third party involved. Failure to gain appropriate agreement can result in material income and expenditure mismatches. This may result in audit adjustments at the year end.</p>
<p>If the cash balance has changed, do you know why? (There are more detailed questions on cash in the 'cash flow statement' section of this checklist.)</p>	<p>This needs to be looked at alongside receivables and payables to get the full picture: low cash balances, growing receivables and payables means cash flow difficulties.</p> <p>If cash balances are falling, does this correspond with a falling surplus or increasing deficit? If not, ask how the financial performance in the comprehensive income and expenditure statement ties up to the movement in cash balances?</p>

Guidance for audit committee members

Balance sheet

Question	Underlying reasoning
If provisions have changed, why is this?	Provisions should be reasonable to cover the organisation against future liabilities. If there are increases in provisions what is the reason for this? Equally, if provisions have fallen, is this because they have been discharged and payment made or is it due to a change in estimates? If the estimation basis has changed, are you happy with the reasons for this change?
If there are large borrowings, do you know what they are?	Does the organisation have any loans that it is in the process of repaying? Has it made the repayments it should have done during the year?
Do the figures seem reasonable and complete, including those entries that are zero?	Where entries for current and prior years are zero, or where a line is missing, check whether this is because of rounding or because it reflects a lack of activity.

Guidance for audit committee members

Cash flow statement

Question	Underlying reasoning
Do the changes in cash and cash equivalents result in a net cash outflow or a net cash inflow?	Liquidity problems are highlighted by cash inflows in the year that are less than cash outflows.
Do you understand the reasons for any large movements?	A large capital programme may result in a net outflow of cash. Equally, loans may result in an increase. However, any unexpected or unexplained large movements may highlight areas for further review.
Does the organisation's reported cash flow position at the year-end correspond with that reported during the year?	If in-year forecasting is accurate, there should not be any surprises at the year end. If there is a significant change, can it be explained?
Has the organisation bought any assets during the year? Can you see them in the payments for property, plant and equipment?	Capital purchases should all be reflected in the capital programme. The overall effect of capital purchases may not affect cash balances if the purchase is funded by a loan. Do the purchases have the expected effect on cash?

Guidance for audit committee members

Cash flow statement

Question	Underlying reasoning
Has the organisation made any loan repayments during the year? Are you aware of the reasons why the organisation has a loan and what its repayment profile is?	If payments are due and have been delayed, is this because there is insufficient cash flow to meet commitments?
Have the organisation's cash balances increased overall during the year? Is there a long term plan as to how to use these balances?	Is this expected? Or is it because payments have been delayed? The cash balances should be in line with reported plans.



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