




ST. HELENA

SAINT HELENA AUDIT SERVICE
MANAGEMENT LETTER
FINANCIAL STATEMENTS 2015 - 16

Laid on the Table - 14 March 2017  CoFC



SAINT HELENA AUDIT SERVICE
External Auditors

MANAGEMENT LETTER

FINANCIAL STATEMENTS 2015-16

To the Executive Council of St Helena Government

21/12/2016

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INTRODUCTION

As the external auditor of Saint Helena Government (SHG), I am required by the Public Finance Ordinance to report to Legislative Council (LegCo) my findings from the audit of the Financial Statements of SHG.

The purpose of this report is to summarise for LegCo the key issues arising from my audit of the Financial Statements for the year ended 31 March 2016 and report any significant accounting matters or weaknesses in internal controls that have come to my attention during the audit.

A draft of this Management Letter was reported to the Financial Secretary and Executive Council (ExCo) for review prior to submission of the final report to the LegCo.

AUDIT OBJECTIVES

The main objective of the audit is to form an opinion as to whether the Financial Statements of SHG present fairly the financial position of Government at 31 March 2016 and of its financial performance and cash flows for the year then ended, and confirm that the financial statements are prepared in accordance with all relevant laws and policies.

As part of my audit I carry out the following work:

- Examine, on a test basis, evidence relevant to the amounts and disclosures in the Financial Statements.
- Assess any significant estimates and judgements made by SHG in the preparation of the Financial Statements.
- Assess whether the accounting policies are appropriate to SHGs circumstances, consistently applied and adequately disclosed.
- Evaluate the overall adequacy of the presentation of information in the Financial Statements to ensure compliance with International Public Sector Accounting Standards (IPSAS).
- Report to you my opinion that:
 - the accounts present fairly the financial position of the Government, as at the end of the financial year then ended; and
 - in all material respects the expenditure and income have been applied to the purposes intended and conform to the authorities which govern them; and
 - the accounts and financial statements have been prepared in accordance with all relevant laws and policies.
- Report to you such other information as I consider necessary or appropriate to assist you in your consideration of the Government's accounts for that financial year.
- Submit for your consideration an annual Management Letter on the audit.

My audit methodology for the collection of audit evidence is based on the Audit Manual of the Saint Helena Audit Service (SHAS), which has been developed to reflect current international auditing standards. The methodology adopts a risk-based approach in accordance with International Standards on Auditing (UK & Ireland).

Although I am required under International Standards on Auditing (ISAs) to consider the risk of material misstatement arising from fraud, the purpose of my audit is not for the detection of fraud. Responsibility for the prevention and detection of fraud rests with the Government who should not rely on the external audit function to discharge these responsibilities.

AUDITOR INDEPENDENCE

The audit engagement team has complied with relevant ethical requirements regarding independence. The following circumstances may present a perceived threat to the independence of the Saint Helena Audit Service:

- The audit of SHG accounts for more than 50% of the annual fee income for SHAS.
- I am appointed by HE the Governor, with the approval of the Secretary of State, and my staff are appointed on the same terms and conditions of service as other public servants of SHG.

The threats to independence in respect of the Financial Statements audit are reduced to an acceptable level through the protections enshrined in the Saint Helena Constitution, in which the Chief Auditor and staff of the Saint Helena Audit Service are not subject to the direction or control of the Governor, the Executive Council or any other person or authority.

All my staff have completed declarations of interest, and where there is an identified conflict, appropriate safeguards have been applied. Through these ethical policies and specific threat mitigation measures I am satisfied as to the independence and objectivity with which the audit is conducted.

AUDIT OPINION

At the conclusion of the audit on 14 December 2016 I issued my Independent Auditor's Report containing a qualified opinion on the financial statements. I based my opinion on the detailed audit work that I carried out in accordance with ISAs.

My opinion on the fair presentation of the Financial Statements is qualified due to uncertainty in the value of capital infrastructure and the accuracy of social benefit payments; and disagreement in the reported comparative balances on reserves in respect of the Bulk Fuel Installation. My report is further modified in respect of the regularity of the pension increase and the statutory requirement to prepare consolidated Financial Statements.

As explained in the following sections these matters remain unresolved at the reporting date. The form of my Independent Auditor's Report containing the qualified opinion is included in Appendix A.

CHANGES TO ACCOUNTS AND SIGNIFICANT MATTERS

FINANCIAL REPORTING FRAMEWORK

Section 10(1) of the Public Finance Ordinance requires that the Annual Financial Statements of Government comply with the IPSAS. The Financial Statements for the year 2015/16 are the fifth year of reporting on an accruals basis using IPSAS. The matters reported in this management letter relate to the draft 2015/16 Financial Statements submitted for audit in July 2016.

The basis of preparation of the Financial Statements as set out in Note 1 explains that the Financial Statements of SHG have been prepared in accordance with IPSAS. IPSAS 6 *Consolidated and Separate Financial Statements* requires SHG to prepare consolidated Financial Statements – whereby ownership interest in subsidiary undertakings are accounted for and presented, along with the separate Financial Statements of Government, as a single economic group. SHG are working towards the preparation of group Financial Statements but for the reporting year 2015/16 the separate Financial Statements of SHG are presented without group consolidation.

There is no transitional exemption in respect of the IPSAS 6 requirements. Accordingly, and consistent with prior-years, my audit report is modified to report that the Financial Statements have not been prepared in accordance with all relevant laws and policies.

LEGACY ISSUES

The following three matters reported in the prior year and causing modification of the 2014/15 audit report also pertain to the current year 2015/16:

- Infrastructure valuation – recognition of airport and wharf assets at fair value
- Social benefit payments – accuracy of expenditure on Basic Island Pension
- Statutory matters – non-preparation of consolidated Financial Statements

As explained more fully in the section below on significant issues resolved with management the following two qualifications reported in 2014/15 are cleared as follows:

- Bulk Fuel Installation – classification of reserves and authorisation of expenditure and revenues pertains only to the 2014/15 comparators and is resolved through the establishment of the BFI Special Fund for 2015/16
- Expenditure in Excess – authorisation of expenditure in excess of statutory appropriation through the section 106 procedure clears this regularity qualification for both 2014/15 and 2015/16

NEW ISSUE

Section 17 of the St Helena Pensions Ordinance provides for pensions in payment under the defined benefit pension scheme to be increased at the discretion of the Governor. When exercising this power the Governor is required to have regard to changes in the wages and salaries paid to serving public officers and employees.

The information provided to the Governor in support of the decision to increase pensions by 6% with effect from 1 April 2015 was deficient in that no reference was made to the zero pay award to public servants for that same financial year. I was therefore unable to obtain sufficient appropriate evidence that the pensions increase made under Section 17, amounting to some £70,080 for 2015/16 and payable from the Consolidated Fund, conforms to the statutory authority that governs it. My audit report is qualified due to a limitation of scope in respect of this new matter of regularity.

MISSTATEMENTS IDENTIFIED DURING THE AUDIT

During my audit, I identified several misstatements. I requested the Financial Secretary to correct these misstatements and they were actioned where it was readily possible. In recognition of your governance responsibilities I have scheduled those material misstatements which have now been corrected in Appendix B. Information which was not available during the preparation of the Financial Statements submitted for audit during July 2016, namely subsidiary audited accounts and pension liabilities, were incorporated into subsequent versions of the Financial Statements.

However, my report also identifies remaining areas of error or uncertainty which, in my opinion, would result in further material adjustments once further work quantified the full extent of the misstatements. These matters remain uncorrected. Their effects on the Financial Statements are described in the section on unresolved matters below and are detailed in Appendix C.

SIGNIFICANT ISSUES ARISING FROM THE AUDIT

ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND FINANCIAL STATEMENT DISCLOSURES

BASIS OF PREPARATION

The accounting policies disclosed are in accordance with IPSAS except for those recognized areas of non-compliance in terms of IPSAS 6 *Consolidated and Separate Financial Statements*, as explained above. After making required adjustments the policies, practices and disclosures are otherwise compliant with IPSAS taking account of transitional provisions and are appropriate to SHG. In overall terms the Financial Statements maintain the improvement in presentation notwithstanding the continuing audit qualifications.

Note 1 sets out the Basis of Preparation and explains that SHG has used certain transitional provisions when preparing the Financial Statements under IPSAS. These transitional provisions are available for a period of up to five years following first-time reporting after which full compliance is required. The Financial Statements for 2015/16 are therefore the final year under which these provisions are applicable and significantly all public assets and leasehold interests held prior to 1 April 2011 will need to be included in the Financial Statements for 2016/17. These accounting requirements will present significant challenges in terms of both financial reporting and statutory audit in the year ahead.

ACTUARIAL ASSUMPTIONS

The Government has a Defined Benefit Pension Scheme (DBPS) which is explained in accounting policies Note 2(i). The DBPS was closed to new members on 31 March 2010 with eligible employees joining after 1 April 2010 being enrolled into the new Defined Contribution Pension Scheme (DCPS). A full actuarial review of the DBPS was performed at 31 March 2016, after three subsequent roll-forward reviews since the last full review performed at 31 March 2012.

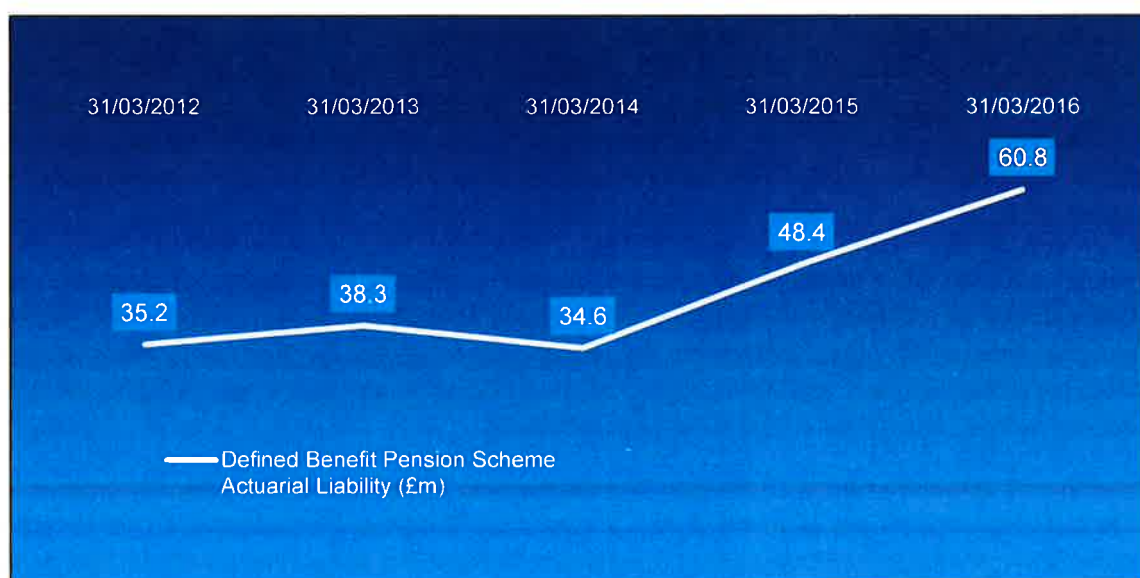
Note 3 sets out the significant assumptions used in preparing the Financial Statements and key sources of estimation uncertainty. The assessment of the pension liability and in-year expense prepared by the Government Actuary are based upon a number of key assumptions. I wish to draw members attention to these actuarial assumptions which have a highly material impact on the preparation of the Financial Statements.

Section 17 of the Pensions Ordinance is a discretionary provision and therefore conveys no absolute legal right to pensions increases. A view could therefore be taken that no constructive obligation has arisen and that instead the pension liability should be valued without taking into account any potential pension increases in the future. However, IPSAS 25 *Employee Benefits* explains that a legal obligation to pay a pension benefit is not the only grounds for recognition of a liability.

The assumptions used by the actuary for future pension increases are represented as being based upon past behaviour (in terms of the historic award of pensions increases) and giving rise to a constructive obligation notwithstanding the discretionary nature of the provision. The forward rate of increase assumed by the actuary for pay and pensions is 3.5% per annum an increase from 2.5% used previously. This rate is represented as being consistent with the historic average rate of pensions increases but also assumes that future pensions increases will be at parity with public sector pay after considering the impact of incremental progression.

Note 20 to the accounts reports that the actuarially assessed pension liability is £60.795m at 31 March 2016 being an increase of £12.371m on the £48.424m balance reported at the previous accounting date. Indeed, the pension liability has increased steeply over the previous two financial years as shown in Figure 1 below.

FIGURE 1 DBPS LIABILITY 2012 TO 2016



Whilst a significant portion of the increase in liability resulted from the change in the discount rate applied by the Government Actuary in 2014/15, the assumed rate of increase in pay and pensions in 2015/16 also has a significant bearing on the measurement of the liability reported in these Financial Statements.

SIGNIFICANT DIFFICULTIES ENCOUNTERED DURING THE AUDIT

I have the pleasure in reporting that the cycle of preparation and audit reporting of the 2015/16 accounts has met the DFID requirement for reporting within nine-months from financial year end and the audit was completed six-months of receipt compliant with the Public Finance Ordinance. The collaborative programme to clear the backlog in the statutory reporting of the Financial Statements has realised its intended purpose and enabled these public accounts to follow a normal reporting timeframe for the first time since the adoption of IPSAS.

The timely production and audit of public accounts is essential for good financial governance and public accountability. SHG are in receipt of significant grant-in-aid and the audited accounts therefore serve to provide assurance to DFID and other international donors. The relevance of the public accounts to external stakeholders and parliamentary scrutiny processes are enhanced when public reporting occurs on a timely basis.

Notwithstanding this progress made in timely financial reporting a significant continuing matter is the scale of changes between the Draft Financial Statements and the Final Audited Statements. The material consequential adjustments required after the reporting of audited accounts for the preceding year is largely a function of the overlapping timelines in the recovery programme.

However, the omission of the amounts, balances and disclosures for the pension liability and in-year charge means that the accounts require material adjustment during the audit process. For 2015/16 the actuarial report was not obtained until 9 November 2016 – some 4 months after the accounts were submitted for audit and less than 5 weeks before the planned audit completion date.

The Financial Secretary assured me that these difficulties were associated with the clearance programme and are non-recurrent in nature. More specifically a detailed closedown plan has been prepared by Corporate Finance for the timely production of the 2016/17 statutory accounts with financial information timeously secured from experts appointed by management including the government actuary, professional valuations, and results of group entities.

SIGNIFICANT MATTERS ARISING FROM THE AUDIT WHICH REMAIN UNRESOLVED

Each of the issues leading to a modification of the audit opinion were discussed with management together with a range of other significant matters. These unresolved matters are summarised in this section.

REGULARITY OF PENSION INCREASE

Section 17 of the Pensions Ordinance provides discretion for the Governor to increase government pensions in payment by an equitable amount having regard to increases in the pay of public servants.

The official advice given to the Governor in support of the requests for decision on the pension increases makes no reference to the pay rates applicable to the general public service. Instead the basis for the increase is made by reference to the minimum income standard (MIS) and is silent on public service pay. SHG officials could not evidence that the Governor had been duly appraised on the public sector pay increases and accordingly the basis for decision does not conform with the specific requirement of section 17.

The Public Finance Ordinance in section 29(b)(i)(B) requires the Chief Auditor to give an opinion as to whether, in all material respects, the expenditure and income have been applied to the purposes intended and conform with the authorities which govern them. I have qualified my regularity opinion in that I was unable to obtain sufficient appropriate evidence that the 2015/16 pensions increase made under section 17 amounting to some £70,080, and payable from the Consolidated Fund, conforms to the statutory authority that governs it.

Recommendation 1 *For future pension increases, the Financial Secretary provides the Governor with specific information on the increase in pay to public servants – to demonstrate compliance with s17 of the Pensions Ordinance 2012.*

ELIGIBILITY OF SOCIAL BENEFIT PAYMENTS

SHG is responsible for the payment of Income Related Benefit (IRB) and Basic Island Pension (BIP) under the Social Security Ordinance 2010. Consistent with 2013/14 and 2014/15 I was unable to secure sufficient appropriate audit evidence about the eligibility of those persons in receipt of BIP.

This material uncertainty on the accuracy of BIP gives rise to a limitation of scope qualification in the audit opinion. The expenditure on BIP in the year to 31 March 2016 was £1.745m (£1.565m in 2014/15). SHG have assigned an Adjudication Officer to review all BIP case files and establish an evidential or adjudicated basis for pension entitlement in each case. This process is expected to be completed by July 2018.

AID FUNDED INFRASTRUCTURE

DFID funded infrastructure in respect of the new airport and permanent wharf amounting to £217.6m at 31 March 2016 (£166.8m at 31 March 2015) reported within Property Plant and Equipment and forming part of assets under construction in Note 16, is required to be measured at replacement cost in accordance with IPSAS 17, *Property Plant and Equipment* and IPSAS 23, *Revenue from Non-exchange transactions*. As explained in Note 3 to the Financial Statements, there is a high degree of estimation uncertainty in using the depreciated replacement cost as a proxy for fair value. In the absence of a professional valuation I am unable to determine whether the stated value fairly reflects the replacement cost for the DFID funded airport and wharf infrastructure.

The Financial Secretary has advised me that he intends to commission a formal valuation of these infrastructure assets as at the date of operational readiness as a basis for future depreciation. The commissioning process remains at an early stage with the scope to be determined, expert to be appointed and valuation exercise to be undertaken. To obtain an independent expert assessment of replacement cost before the audit reporting deadline of 31 December 2016 therefore remains impractical. In these circumstances, there is a practical limitation of scope presented by management that causes a qualification of the audit opinion on the grounds of material uncertainty.

SIGNIFICANT MATTERS ARISING FROM THE AUDIT THAT WERE RESOLVED WITH MANAGEMENT

Each of the issues highlighted below were identified during the audit and satisfactorily resolved with management and appropriate adjustments made to the final Financial Statements. The material adjustments arising are disclosed in Appendix B.

ACTUARIAL ASSESSMENT

The valuation of the Defined Benefit Pension Scheme (DBPS) was received from the Government Actuary's Department in November 2016. Accordingly, the actuarial adjustments to recognise the pension costs and liability had not been recorded in the draft Financial Statements submitted for audit. The required adjustments have now been made in the Financial Statements and are disclosed in Note 20 – Pensions.

PROVISION FOR LITIGATION

SHG were engaged in several on-going legal proceedings at reporting date for which no provision had initially been made in the financial statements. Management have now assessed the probability of economic outflows and a reasoned estimate for the accounting provision has now been included in the financial statements.

In my Final Accounts Memorandum to the Financial Secretary for 2012/13 I had raised the requirement for the Corporate Finance team to liaise with the Attorney General's Chambers in respect of provisioning for current litigation and claims. It was evident from my enquiries that further action is required to improve the process and coordination between Finance and Legal functions.

REALLOCATION OF SHIPPING UNDERSPEND

Confirmation was received from DFID that the £2.056m underspend on shipping subsidy may be retained by SHG to meet the cost of the new Fuel Management Contract (FMC) with the balance being transferred to Grant in Aid. Adjustments were processed between DFID Shipping Subsidy, DFID Grant in Aid and DIFD Development Aid recognised within Trading Activities to reflect these authorised transfers.

VALUATION OF AIRPORT

An error of £3.566m was identified in the fair value estimate of the airport project. The error was the result of SHG only including in-year rather than total cumulative costs of Variation Orders, Diesel, Explosives and Risk Share being included in the estimate. The Government Financial Statements have been adjusted to correctly reflect this cost.

TRANSFER OF COMPLETED ASSETS UNDER CONSTRUCTION

Various elements of capital expenditure on the main wharf in Jamestown was completed between 2010/11 and 2012/13. However, the capital expenditure had not been transferred out of the Assets Under Construction class in Note 16 - Property, Plant and Equipment on completion, and so was not subject to depreciation. The error was identified prior to the finalisation of the Financial Statements. Prior period adjustments for the reclassification from Assets Under Construction to the Infrastructure, Infrastructure Roads and Land and Buildings classes of Note 16 - Property, Plant and Equipment and depreciation charges were made. These are disclosed in Note 4 - Restatement of Prior Period Figures.

AID FUNDED INFRASTRUCTURE RESERVE

To simplify financial reporting, management decided to combine the previously separate Airport Infrastructure Reserve £216.629m at 31 March 2016 (£202.685m at 31 March 2015) and the Wharf Infrastructure Reserve £9.952m at 31 March 2016 (£9.535m at 31 March 2015) into a single Aid Funded Reserve. The change has been explained in Note 3 and the consequential amendments made to the Statements of Financial Position and Note 23 and related notes in the Financial Statements.

RECOGNITION OF ESH CAPITAL IMPROVEMENTS

Enterprise St Helena is an arm's length agency established under Ordinance to facilitate the economic development of St Helena. The agency enjoys an operating subsidy from SHG and project funds from DFID routed through SHG as the sponsoring government. In the year 2015/16 ESH applied some £0.713m of funding to making capital improvements to specific properties owned by SHG. These capital additions were required to be recognised by SHG in its separate Financial Statements and the associated operating subsidy to ESH adjusted to reflect the substance of these related party transactions.

RECLASSIFICATIONS

There have been a range of material adjustments processed by management with audit agreement to correctly classify items of account in the Financial Statements as disclosed in Appendix B. Several are consequential adjustments expected from the closure of the financial statements for the prior year 2014/15 on 14 September 2016 being after the submission date for the draft financial statements for 2015/16 on 15 July 2016. These material items are set out in the paragraphs below.

ALLOCATION OF TECHNICAL COOPERATION EXPENDITURE

During the financial audit 2014/15 of payroll Technical Cooperation (TC) allocation, I noted that items included in the allocation of TC costs per directorate and per cost type were incorrectly classified. Adjustments were therefore required to the Statement of Financial Performance for prior year ended 31 March 2015 and current year ended 31 March 2016 figures, as well as amendments to Note 5 of the Financial Statements. The total reallocation amounting to £1.62m for 2015/16 did not impact reported total expenditure.

WHARF INFRASTRUCTURE

The permanent wharf infrastructure reported within assets under construction is financed through a combination of DFID and EDF grant funding. The accounting treatment adopted in the draft Financial Statements was to recognise the asset under construction at cost. IPSAS 23 requires that where an asset is acquired through a combination of exchange and non-exchange transactions, those components should be distinguished, with the EDF funded component recognised at cost (on an exchange basis) and the DFID funded recognised at fair value (on a non-exchange basis). Management have therefore amended the disclosure of accounting policies in Note 1 and key estimation assumptions in Note 2 to properly reflect the mixed funding for the wharf infrastructure.

Nonetheless the absence of a reliable measure of fair value means for the DFID component means that the qualified opinion relating to the airport infrastructure similarly applies to the new permanent wharf in Rupert's bay.

OTHER MATTERS ARISING FROM THE AUDIT THAT ARE SIGNIFICANT TO THE OVERSIGHT OF THE FINANCIAL REPORTING PROCESS

The following matters relate to the statutory reporting framework, good governance and financial management. They are relevant to the oversight of the financial reporting process and improving accountability in the public administration of St Helena.

COMPLIANCE WITH FINANCIAL REPORTING FRAMEWORK

Section 10(1) of the Public Finance Ordinance requires the financial statements to be prepared in accordance with the IPSAS financial reporting framework. IPSAS requires an explicit and unreserved statement of compliance to be made. As disclosed in Note 1 Government has not prepared consolidated financial statements that incorporate the results of those entities over which SHG has control and accordingly has not complied with IPSAS 6, *Consolidated and Separate Financial Statements*.

Section 29(1)(b)(i)(C) of the Public Finance Ordinance requires the Chief Auditor to provide an opinion on whether the accounts and financial statements have been prepared in accordance with all relevant laws and policies. In my Independent Auditor's Report I have therefore reported, in the section '**on other matters required by statute**', that the financial statements have not been prepared in accordance with all relevant laws.

In response to my previous recommendations on this issue, Corporate Finance has commenced a plan for staged consolidation over two reporting periods to minimise the reporting burden on subsidiaries. The intention is to publish consolidated Financial Statements for SHG and its economic group for the financial year 2016/17.

EXPENDITURE WITHOUT AUTHORITY

The Statement of Comparison of Budget and Actual Amounts and related Note 7 to the Financial Statements reports heads of expenditure and revenue at output level compared with the budget estimate. Expenditure exceeding the limit of the approved estimate is without authorisation and is required to be scheduled in a Statement of Expenditure in Excess in accordance with Section 106 of the Constitution.

In the financial year 2015/16 there are three heads of expenditure which are reporting Expenditure in Excess:

- **Police** – Overspend of £20,465 on a budget of £1.237m
- **Corporate Finance** – Overspend of £74,805 on a budget of £3.880m
- **Safeguarding** – Overspend of £160,557 on a budget of £2.754m

In Sessional Paper 41/16 the Financial Secretary laid a Statement of Expenditure in Excess before Legislative Council consistent with Section 106. The Public Accounts Committee (PAC) have examined the Statement and taken evidence from Accounting Officers as to the reasons for the Excess Expenditure. The resultant PAC report was laid in Sessional Paper 44/16 and a motion passed to allow the expenditure to stand charged to public funds.

These items would ordinarily cause a qualification to the regulatory opinion in my Independent Auditor's Report. Their subsequent authorisation by LegCo on 12 December 2016 upon completion of the constitutional process under Section 106 avoids a qualification of the regularity opinion on these grounds in 2015/16.

In my briefing to PAC on the content of Sessional Paper 41/16 I highlight the Statement of Expenditure in Excess covers the five financial years 2011/12 through to 2015/16. This remedies an historic procedural defect in that Excess Expenditure arising in prior years had not been subject to review and authorisation under Section 106. The Financial Secretary has also committed, in respect of any future overspending, to lay a statement of Expenditure in Excess before LegCo upon the close of each financial year.

WRITTEN REPRESENTATIONS

Written representations were requested and received from the Financial Secretary in line with those required by the International Standards on Auditing.

GOING CONCERN

The annual recurrent spend by SHG is 77% (£19.271m of £25.119m) funded from direct grant from DFID. I have therefore considered SHG's assessment that the Government as an economic reporting entity is a going concern.

I am satisfied that the going concern reporting basis is appropriate based on my reading of the DFID Memorandum of Understanding for financial support to SHG covering the periods 1 April 2016 up to 31 March 2019, my review of recurrent estimates, and my discussions with the Financial Secretary. The amount pledged by DFID for the 2016/17 budget year will not exceed £22.5m and includes the allocation towards Technical Cooperation.

ANNUAL GOVERNANCE STATEMENT

Consistent with best public sector practice SHG has prepared an Annual Governance Statement (AGS) for 2015/16 for publication with the Financial Statements. As Chief Auditor I am obliged to review the AGS and consider whether it conforms to proper practice and the reported content is not inconsistent with my knowledge of the entity.

The publication of an AGS represents a voluntary disclosure and accordingly there is currently no regulatory basis requiring publication with the accounts of Saint Helena Government or prescribing its form. In the absence of specific regulation, the form has been reviewed in comparison with the model framework published by Chartered Institute of Public Finance and Accountancy (CIPFA).

The following issues were identified and discussed with management:

- The improvements applied in respect of the AGS published with the 2012/13 Financial Statements had not been carried through to the draft AGS for 2015/16
- There was no explicit statement which says that the governance framework has been in place for the year and up to the date of approval of the Financial Statements.
- The opinion from the Head of Internal Audit was not included in the AGS.

- The section on Significant Governance Issues was not consistent with the assurances from Accounting Officers and the findings from Internal Audit

Revisions were subsequently made by management such that the AGS conforms to proper practice and the reported content is consistent with the Financial Statements and my audit understanding of SHG in the period under report.

In my 2012/13 Management Letter, I recommended the publication of a Code of Governance against which an express statement of compliance may be made in the AGS as envisaged by the model statement. SHG had intended to publish a Code consistent with the CIPFA/IFAC governance framework in preparation for 2016/17 statutory reporting. However, this timetable now looks somewhat ambitious.

FINANCIAL MANAGEMENT AND INTERNAL CONTROL

In accordance with International Standards on Auditing I have included a summary of matters of financial management and internal control which arose during my audit and which I consider should be brought to the attention of LegCo.

The matters described in this section came to my attention during the normal course of my audit, the purpose of which was to express an opinion on the Financial Statements. The audit included consideration of internal control relevant to the preparation of the Financial Statements to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control.

Overall responsibility for maintaining adequate financial reporting systems and systems of internal control, as well as for the prevention and detection of fraud, irregularities, and other errors, rests with the Financial Secretary and the Accounting Officers.

NEW ISSUES RAISED THIS YEAR

The new matters now reported are limited to those deficiencies that I consider to be of sufficient importance to merit being reported to Council. Less significant matters will be reported to the Financial Secretary in a separate Final Accounts Memorandum. I have noted in the Appendix D the actions proposed by management regarding the audit recommendations made in this Letter.

PENSIONS INCREASES

The increase applied to pensions in payment in recent years has referenced the Minimum Income Standard and therefore the historic trend appears quite different to increases in public service pay. Indeed, over the period since 2010/11 pensions in payment have increased by 16% more than public service pay. Whilst the Governor has an absolute discretion in determining an equitable pension increase officials should reference the public service pay comparator when providing a rationale for future decisions.

The DBPS has no corresponding assets and accordingly pensions in payment continue to fall upon the Consolidated Fund on a pay-as-you-go basis with SHG remaining exposed to this unfunded liability. Therefore, for the purpose of prudential financial management, in explaining the financial consequences of any proposed pension increase officials should also quantify the impact on the future pension liability in addition to the in-year budgetary requirement for estimates purposes.

***Recommendation 2** For future pension increases, the Financial Secretary provides the Governor with information on the prudential impact on the unfunded pension liability in addition to the in-year budgetary requirement.*

CAPITAL PROGRAMME MANAGEMENT

Government has an ambitious capital programme to construct and renew built infrastructure essential for the maintenance of public services and the future economic development of the Island. In recent periods the capital programme has suffered from ineffective programme and project governance and inadequate technical capacity. In consequence, the delivery of built infrastructure to quality, budget and timetable has fallen well short of the planned investment programme to the frustration of both elected members and external donors.

More specifically, the £16.5m DFID funded 3-year support to SHG capital programme 2014/15 to 2016/17 was placed in special measures after significant capital slippage was evident after year two of the programme. These issues have been more fully reported in the 2015 and 2016 reports of the DFID infrastructure advisor. There are also issues evident from the internal reviews on specific capital projects reported by Internal Audit during 2015/16.

I am reassured that there is a clear commitment to turnaround the management of the capital programme by SHG. Planned corrective actions include the implementation of a range of measures contained in the Performance Improvement Plan (PIP) agreed with DFID. Accordingly, I make no additional recommendations at this moment but will maintain a watching brief on developments and maintain a dialogue with Executive Management and the Public Accounts Committee regarding any necessary audit interventions.

TRANSFERS OF DFID FUNDED ASSETS

The UK Government (via the Department for International Development – DFID) funds a significant portion of SHG's Property, Plant and Equipment (purchased directly and indirectly through DFID) as well as Infrastructure Assets (both completed and under construction, reported within the Property, Plant & Equipment in Note 16). Whilst SHG has control from an accounting perspective, these assets remain the official property of DFID until legal transfer to SHG is completed.

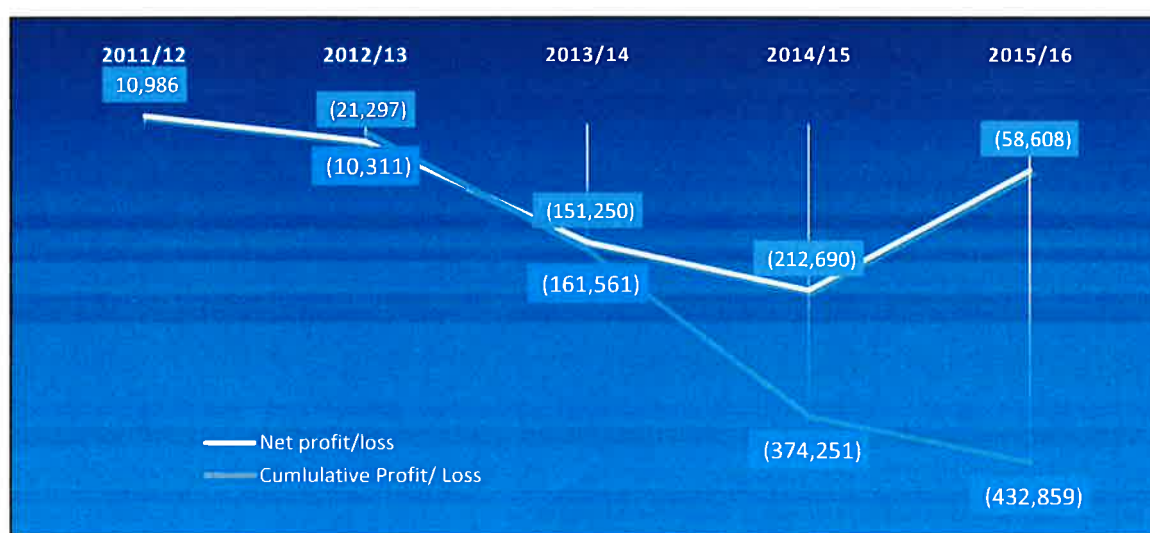
***Recommendation 3** SHG should secure from DFID legal transfer of aid funded assets to the ownership of SHG and update the asset register accordingly.*

BULK FUEL INSTALLATION

The Bulk Fuel Installation (BFI) is managed on behalf of the Government through a service concession with Solomon & Company. In accordance with the Management Agreement, the manager, Solomon & Company, maintains an account for the transactions of the BFI and those financial statements are audited by the Chief Auditor. As a Government trading activity SHG have established a Special Fund in Note 23 for the express purpose of distinguishing the financial affairs of the BFI from the Consolidated Fund.

In my report to the Financial Secretary on my audit of the BFI account for 2013/14 I drew specific attention to the reported operating loss for the Bulk Fuel Installation which indicated that the fuel pricing model is not recovering the long run operating costs of the BFI. ExCo approved an increase in the overhead mark-up from 8p to 12p per litre, with effect from September 2015 which has reversed this downward trend as shown in Figure 2 below.

FIGURE 2 BFI FINANCIAL PERFORMANCE



Members need to ensure that commercial trading activities of Government, such as the provision of wholesale fuels, reflects the full economic costs of their operation after taking account of any approved policy to provide public subsidy. The consequence of not adjusting the overhead recovery to reflect the real cost of BFI operations over this five-year period has resulted in an untargeted public subsidy of some £379,000 after adjusting for accelerated depreciation.

REDUNDANT SPECIAL FUNDS

Disclosed within Note 23 to the Financial Statements are a range of Special Funds established by order and enable individual projects and trading activities to be accounted for separate to the Consolidated Fund – these are grouped into three categories:

- Special Funds – Projects
- Special Funds – Trading
- Special Funds – Other

It is apparent that some Special Funds may no longer be required for their intended purpose or are otherwise redundant. This may be because the statutory purpose of the fund is no longer relevant to the current business of Government – for example DFID Funded Short Term Cooperation Fund which is no longer managed separately from DFID Grant-in-Aid; or have no transactions in the previous two financial years and are clearly dormant – for example the DFID Technical Cooperation Fund; or are both redundant and dormant – for example the Unallocated Stores Trading Account whose inventory was transferred upon the establishment of Connect St Helena Ltd.

My particular concern are those Special Funds which appear both dormant and report an overdrawn position at the financial year end. These include the following two funds, which if no longer required, should be closed and the balances either recovered or otherwise properly authorised for write-off against the Consolidated Fund:

- DFID Technical Cooperation £230k
- Unallocated Stores Trading Account £119k

There is an opportunity for the Financial Secretary to review the continuing need for the various Special Funds and Reserves necessary for the effective financial management and accounting for the Government of St Helena.

Recommendation 4 *The Financial Secretary should perform a comprehensive review of special funds and reserves necessary for the effective financial management and accounting for the Government of St Helena.*

FOLLOW-UP OF PREVIOUS ISSUES

Audit recommendations made in previously issued Management Letters for 2011/12 through 2014/15 were followed-up with management. The status of those items recommendations remaining open is summarized in the table below.

Recommendation	Follow-up status
Recommendations from 2011/12	
1. Introduction of accruals budgeting	Pending – Financial Secretary gave a commitment to PAC that accruals based budgeting will be introduced but with delayed implementation to 2019/20
Recommendations from 2012/13	
2. A separate review engagement should be commissioned in respect of EDF funded infrastructure to give specific assurance that the grant funds have been applied for the purposes intended.	Pending – Corporate Finance will approach EDF and request clarity on the audit procedures to be followed and share this with SHAS.

Recommendation	Follow-up status
3. A Code of Governance should be developed with reference to the CIPFA/IFAC International Framework on Good Governance in the Public Sector and adopted as a standard against which compliance may then be measured in the AGS.	Pending – To be reviewed and implemented in time for 2016/17 reporting.
Recommendations from 2014/15	
4. SHG should review all legacy applications in relation to eligibility of social benefit payments and obtain documentations from the applicants to maintain on their records to confirm eligibility.	Pending – SHG have recruited an additional Adjudication Officer for the Social Security Office. Their primary role will be the review, updating and collating of eligibility data for all recipients who were brought over from the old system in 2011 to provide assurance on the payment of the current Basic Island Pension.
5. SHG should procure the services of an independent and qualified professional valuer to determine the replacement cost value of the Airport and Wharf Infrastructure	Pending – Corporate Finance intend to secure the services of a professional valuer to determine the value of the Airport Infrastructure once the work has been certified
6. SHG should prepare Group Financial Statements consolidating the results of the subsidiary entities. These group statements are required under IPSAS 6 in addition to the separate Financial Statements of SHG.	Pending – Corporate Finance has commenced a plan for staged consolidation from 2015/16 financial statements onwards with a view of addressing this recommendation over two reporting periods to minimise the reporting burden on subsidiaries. Financial results will be consolidated with the results of five controlled entities in the 2016/17 Financial Statements.

CONCLUDING REMARKS

I acknowledge and thank the officers of Saint Helena Government, and in particular the Corporate Finance team, for their assistance and co-operation given to the SHAS during the course of the statutory audit for 2015/16.

A handwritten signature in blue ink, appearing to read 'Phil Sharman'.

Phil Sharman
Chief Auditor for St Helena
St Helena Audit Service

21 December 2016

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SAINT HELENA GOVERNMENT

I have audited the financial statements of St Helena Government for the year ended 31 March 2016 under the Public Finance Ordinance 2010. The St Helena Government financial statements comprise the Statement of Financial Performance, Statement of Financial Position, Statement of Changes in Net Assets, Statement of Cash Flows, Statement of Comparison of Budget and Actual Amounts, Statement of Revenue and Expenditure upon the Consolidated Fund and Special Funds, Statement of Trust Fund Movements, and the related notes.

Respective responsibilities of the Financial Secretary and the Chief Auditor

The Financial Secretary is responsible for preparing the financial statements in accordance with International Public Sector Accounting Standards (IPSAS) and being satisfied that they present fairly the financial position, financial performance, and cash flows of St Helena Government. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable legal and regulatory requirements and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practices Board (APB) Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the government's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Financial Secretary; and the overall presentation of the financial statements.

I also assess whether the accounts and financial statements have been prepared in accordance with all relevant laws and policies; and whether in all material respects the expenditure and income have been applied to the purposes intended and conform to the authorities which govern them.

I read all the financial and non-financial information published with the financial statements to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

1. Classification of reserves

The Bulk Fuel Installation (BFI) is a trading activity of Government for which a Special Fund was established during the year ended 31 March 2016. Prior to the establishment of this Fund the BFI reserve was incorrectly classified within Special Funds in the Statement of Financial Position and Note 23 rather than within the Consolidated Fund. The impact on the financial statements is overstatement of the prior year comparators only for Special Funds, in the amount of £3.340m at 31 March 2015, and an understatement of the Consolidated Fund balance at 31 March 2015 to the same extent.

2. Infrastructure valuation

Aid funded infrastructure amounting to £217.6m at 31 March 2016 (£166.8m at 31 March 2015) reported within Property Plant and Equipment in the Statement of Financial Position, and forming part of assets under construction in Note 16, is measured on an earned value basis. IPSAS 17, *Property Plant and Equipment* and IPSAS 23, *Non-Exchange Transactions* require that such aid funded assets are measured at replacement cost. Note 3 explains there is a high degree of estimation uncertainty associated with the valuation of the airport and wharf infrastructure.

I was unable to obtain sufficient appropriate audit evidence regarding the asset valuation by the reporting date, either from management or by using alternative audit procedures. In these circumstances, I am unable to determine whether the use of an estimate based on earned value would give rise to a material misstatement, and whether any adjustment was necessary to the reported value of Property Plant and Equipment and associated reserves.

3. Accuracy of social benefit payments

Government is responsible for the payment of a social benefit in the form of Basic Island Pension. The expenditure on this social benefit, forming part of Benefit Payments in the Statement of Financial Performance, was £1.745m in 2015/16 (£1.565m in 2014/15). I was unable to obtain sufficient appropriate audit evidence about the accuracy of these pension payments because no evidence of eligibility is obtained or retained by Government. I was therefore unable to determine whether any adjustment to the reported expenditure was necessary.

Qualified opinion on the financial statements

Except for:

- the understatement of the prior year comparator for the Consolidated Fund and the overstatement of the prior year comparator for Special Funds, as detailed in paragraph 1 of the Basis for qualified opinion section above; and
- the possible effects of the matters described in paragraphs 2 and 3 of the Basis for qualified opinion section above;

in my opinion, the financial statements present fairly the financial position of St Helena Government as at 31 March 2016, and its financial performance and cash flows for the year then ended in accordance with International Public Sector Accounting Standards.

Basis for qualified opinion on regularity

Section 17 of the St Helena Pensions Ordinance provides for pensions in payment under the defined benefit pension scheme to be increased at the discretion of the Governor. When exercising this power the Governor is required to have regard to changes in the wages and salaries paid to serving public officers and employees. The information provided to the Governor in support of the decision to increase pensions by 6% with effect from 1 April 2015 contained no reference to the decision to award no pay increase to public servants for the same financial year. I have been unable to perform alternative audit procedures to obtain sufficient appropriate evidence as to whether the Governor had regard to this matter.

Qualified opinion on regularity

In my opinion, except for possible effects of the matter described in the Basis for qualified opinion on regularity paragraph above, in all material respects the expenditure and income has been applied to the purposes intended and conforms to the authorities which govern them.

Opinion on other matter required by statute

Section 29(1) (b) of the Public Finance Ordinance requires me to report on whether the financial statements have been prepared in accordance with all relevant laws or policies.

Section 10(1) of the Public Finance Ordinance requires the financial statements to be prepared in a manner consistent with the International Public Sector Accounting Standards (IPSAS). IPSAS require an explicit and unreserved statement of compliance to be made. As disclosed in Note 1, and contrary to the requirements of IPSAS 6, *Consolidated and Separate Financial Statements*, Government has not prepared consolidated financial statements for the economic entity that incorporate the results of the entire group.

In consequence, in my opinion, the financial statements have not been prepared in accordance with all relevant laws or policies.

Phil Sharman CPFA CA
Chief Auditor for St Helena

14 December 2016

St Helena Audit Service, Jamestown, St Helena

SCHEDULE OF MATERIAL ADJUSTMENTS

APPENDIX B

I identified the following misstatements during my audit and management have adjusted the financial statements to correct these errors. The table does not repeat the restatements of prior year figures already presented in Note 4 to the Financial Statements.

Table 1: Material adjustments to the financial statements: requested by audit

Adjusted misstatement	Statement of Financial Position		Statement of Financial Performance	
	Dr £'000	Cr £'000	Dr £'000	Cr £'000
2015/16				
<i>Being entry to correct the Airport Fair Value and Prepayment</i>				
PPE: Assets Under Construction	3,566			
Prepayments: Airport		3,566		
<i>Being the shipping subsidy under spend agreed with DFID to be utilised against the fuel management contract therefore should have been transferred to the BFI special fund as DFID Development Aid rather than to the Grant in Aid line</i>				
Grant in Aid			294	
DFID Development Aid				294
<i>Being adjustment to provide for compensation payments for litigation ongoing at reporting date</i>				
Compensation payments – GPS / Other Expenditure			413	
Provision for compensation payments		413		

Management also identified a number of misstatements during the audit and have adjusted the financial statements to correct these errors. Adjustments we deem to be immaterial in value individually have not been reported here. The table does not repeat the restatements of prior year figures already presented in Note 4 to the financial statements.

Table 2: Material adjustments to the financial statements: requested by management

Adjusted misstatement	Statement of Financial Position		Statement of Financial Performance	
2015/16	Dr £'000	Cr £'000	Dr £'000	Cr £'000
<i>Being entry to reflect the audited profit/ loss and other equity movements of each subsidiary</i>				
Investment in Connect St Helena Ltd	216			
Investment in Bank of St Helena Ltd	287			
Investment in Solomon & Company PLC	225			
Share of Profit on Equity Accounted Investments				728
<i>Being adjustments to recognise actuarial movements in pension liability (GAD Report)</i>				
Reserves: Pension Reserve (Actuarial Losses)	11,001		951	
Expenditure: Public Sector Pensions - Employee Costs (Current Service Cost)			670	
Expenditure: Public Sector Pensions - Employee Costs (Past Service Cost)			1,062	
Expenditure: Public Sector Pensions - Employee Costs (Interest Cost)		13,684		
Non-current Liabilities: Pension Liability				
<i>Being entry to recognise capital expenditure incurred by ESH on SHG assets.</i>				
PPE: Land & Buildings – Cost	433			67
Expenditure: Economic Development - Payments to Other Agencies, Bodies or Persons				366
Expenditure: Economic Development - Payments to Other Agencies, Bodies or Persons				
Reserves: General Reserve	67			
Reserves: DFID Projects	366			
Reserves: Capital Reserve		433		

Table 3: Material adjustments to financial note disclosures

Description of correction	Note affected	Value of the error £'000
Figures from the BFI accounts were not available to be included in v1 of the Financial Statements as they had not been prepared and audited	Throughout the financial statements	Various
Reclassification of Horse Point Waste Management Site to Land & Buildings from Infrastructure to Land and Buildings	Note 16 – Property, Plant and Equipment	1,132
Presentational changes – amendment to notional allocation of Long Term TC costs by nature of expense. Includes correction of costs allocated to GPS in error instead of Police and ENRD respectively.	Note 5 – Expenditure by category	1,622
Correction of the descriptions and values of the capital commitments	Note 28 – Capital Commitments	Narrative
Improvement in accounting policies relating to property plant and equipment and related note on significant estimation assumptions arising from the accounting treatment for airport and wharf infrastructure	Note 1 (a) – Accounting policies Note 3 – Key estimation assumptions	Narrative
Omission from Note 26 – events after the reporting date regarding buildings transferred to St Helena Hotel Development Limited on 1 July 2016	Note 26 – Events after the Reporting Date	2,100
Combination of previously separate Airport Infrastructure Reserve and Wharf Infrastructure Reserve into a single Aid Funded Reserve	Note 4 – Restatement of prior period figures Note 23 – Funds and Reserves	Narrative
Correction of some of the values of the exceptions to arm's length transactions with controlled entities	Note 25 – Related Party Transactions	Narrative

In accordance with ISA 450 I am required to communicate to management any uncorrected misstatements and request a written representation from those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, either individually and in aggregate.

Management have adjusted the financial statements for all misstatements identified at the audit other than the following:

- Potential adjustments arising from the valuation of airport and wharf infrastructure on a replacement cost basis – the financial effect cannot be quantified until a professional valuation report is secured
- Potential adjustments arising from inaccuracy in payment of basic island pension – the financial effect cannot be quantified until the review of eligibility is completed by the adjudication officer
- Extrapolated errors from audit testing – the financial effect of these projected soft errors are scheduled in Table 1 below
- Reclassification of the BFI Special Fund in prior year – the BFI special fund was not established until 2015/16 so the error applies to 2014/15 comparators

Table 1: Uncorrected misstatements in the main Financial Statements

Misstatement	Statement of Financial Performance		Statement of Financial Position	
	Dr £'000	Cr £'000	Dr £'000	Cr £'000
<i>Description</i>	<i>Value</i>		<i>Value</i>	
<i>Pertaining to current year</i>				
<i>Aggregate soft error projections from audit testing affecting:</i>				
Expenditure				29
Inventory		14		
Payables	43			
<i>Pertaining to prior year</i>				
<i>BFI reserve reported within Special Funds not Consolidated Fund</i>				
Special Funds			3,340	
Consolidated Fund				3,340

No	Observation	Recommendation	Priority	Response & timescale
1	Regularity of Pension Increases Section 17 of the St Helena Pensions Ordinance provides for pensions in payment to be increased at the discretion of the Governor. The information provided in support of the decision to increase pensions by 6% with effect from 1 April 2015 was deficient in that no reference was made to the zero pay award to public servants for that same financial year.	For future pension increases, the Financial Secretary provides the Governor with specific information on the increase in pay to public servants – to demonstrate compliance with s17 of the Pensions Ordinance 2012.	H	Agreed. All future proposals from the Financial Secretary to the Governor with regard to section 17 of the Pensions Ordinance will contain information relating to changes in wages and salaries of public servants.
2	Prudential Impact of Pensions Increases The unfunded pension liability has increased steeply in recent years to £60.795m at 31 March 2016. The DBPS has no corresponding assets and accordingly pensions in payment continue to fall upon the Consolidated Fund on a pay-as-you-go basis. Recent pensions increases have not considered the prudential impact on the future pensions liability.	For future pension increases, the Financial Secretary provides the Governor with information on the prudential impact on the unfunded pension liability in addition to the in-year budgetary requirement.	M	Remains under consideration. Financial Secretary to discuss with GAD an estimation basis for prudential financial management in addition to in-year budgetary requirement.
3	Transfer of DFID Funded Assets DFID funds a significant portion of SHGs property plant and equipment through earmarked Development Aid. Whilst SHG has control from an accounting perspective these assets remain the official property of DFID until formal transfer to SHG is effected.	SHG should secure from DFID the legal transfer of aid funded assets to the ownership of SHG and update the asset register accordingly	M	Agreed. SHG will seek formal transfer of assets from DFID. This will be an ongoing process when assets are completed. Responsibility: Assistant Financial Secretary

No	Observation	Recommendation	Priority	Response & timescale
4	<p>Funds and Reserves</p> <p>Some Special Funds may no longer be required for their intended purpose or are otherwise redundant. Of concern are those Special Funds which appear both dormant and report an overdrawn position at the financial year end. These include the following two funds, which if no longer required, should be closed and the balances either recovered or properly authorised for write-off against the Consolidated Fund:</p> <ul style="list-style-type: none"> • DFID Technical Cooperation £230k • Unallocated Stores Trading Account £119k 	<p>The Financial Secretary should perform a comprehensive review of special funds and reserves necessary for the effective financial management and accounting for the Government of St Helena.</p>	M	<p>Agreed.</p> <p>A comprehensive review of special funds and reserves will be completed by the Head of Finance Services by March 2016 and reported to the Financial Secretary.</p>

DEFINITION OF PRIORITIES

HIGH	Immediate risk of error, loss of cash or other assets or significant non-compliance with relevant Ordinances or regulations. Action should be taken on these within 2 months.
MEDIUM	Issues identified which would improve the quality of financial reporting and/or internal control systems. Action should be taken on these within 6 months, or by the end of the next financial reporting period, whichever is the earliest.

As explained in the paragraph on other matters relating to non-consolidating group entities, the Financial Statements do not present the financial results of the group as required by IPSAS 6, *Consolidated and Separate financial statements*. The group entities that should have been consolidated along with the separate Financial Statements of SHG are:

- Bank of St Helena Ltd
- Connect St Helena Ltd
- St Helena Hotel Development Ltd
- Solomon & Company (St Helena) PLC
- St Helena Line Ltd
- St Helena Currency Fund
- St Helena Fisheries Corporation
- Enterprise St Helena

The lack of consolidation means that I am unable to report on the internal control arrangements of group entities. I have not carried out such audit work on the group entities which I act for, nor communicated with other component auditors.

