SAINT HELENA AUDIT SERVICE
External Auditors

MANAGEMENT LETTER

FINANCIAL STATEMENTS 2016-17

To the Legislative Council of St Helena Government

29/03/2018

CONTENTS

INTRODUCTION

As the external auditor of Saint Helena Government (SHG), I am required by section 29(1) of the Public Finance Ordinance (the 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 2017 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) to discharge my responsibilities under ISA 260, *Communication with Those Charged with Governance,* prior to final submission to LegCo in accordance with section 29(2) of the Ordinance.

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 2017 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 my opinion under section 29(1)(b) that:

    (A) The accounts properly present the financial position of the Government, as at the end of the financial year then ended; and

    (B) In all material respects the expenditure and income have been applied to the purposes intended and conform to the authorities which govern them; and

    (C) The accounts and financial statements have been prepared in accordance with all relevant laws and policies.

- Report 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 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 International Auditing Standards (ISAs).

Although I am required under 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 SHG 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 the SHG financial statements represents more than 30% 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 his staff are not subject to the direction or control of the Governor, ExCo 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.

INDEPENDENT AUDITOR’S REPORT

At the conclusion of the audit I issued my Independent Auditor’s Report (my Report) on the Financial Statements – the auditor’s report is the key output of the audit process. The form of my Report is prescribed by ISA 700 (Revised) – *Forming an Opinion and Reporting on Financial Statements.* The revised standard includes enhancements to the report designed to increase confidence in the audit and the Financial Statements, in the public interest.

My Independent Auditor’s Report now includes:

- Opinions followed by the basis for those opinions
- Enhanced reporting on going concern
- A new section on key audit matters
- A new section on other information presented with the Financial Statements
- An affirmative statement on independence and ethical compliance
- An enhanced description of auditor responsibilities

The structure of my Report clearly separates my reporting on the audit of the Financial Statements performed under the ISAs from my reporting on any other audit matters arising from my responsibilities under statute – specifically the Public Finance Ordinance.

As explained in the above section on audit objectives my Report contains three opinions as required by section 29 of the Ordinance:

- Opinion on fair presentation of the accounts
- Opinion on regularity of expenditure and revenue
- Opinion on compliance with statutory authorities

For the financial year end my Report is qualified on five separate counts:

- Two qualifications of fair presentation – being scope limitation as to the reported value of aid-funded infrastructure and the reported balances of certain special funds
- Two qualifications of regularity – being expenditure incurred in excess of authority on certain heads and scope limitation on the regularity of pension increases
- One qualification on statutory compliance – being non-preparation of consolidated Financial Statements

As explained in the following sections these five matters remain unresolved at the reporting date. Without qualifying my Report I also draw attention to a material uncertainty on going concern and explain that the valuation of public assets presented a significant audit risk and was addressed through my procedures.

The form of my Independent Auditor's Report containing these qualified opinions and other reporting matters is included in Appendix A.

CHANGES TO ACCOUNTS AND SIGNIFICANT MATTERS

LEGACY ISSUES

As explained more fully in the section below on significant issues which remain unresolved the following three matters reported in the prior year, and causing modification of the 2015/16 Auditor's Report, also pertain to the current year 2016/17:

- Infrastructure valuation – recognition of airport and wharf assets at fair value
- Statutory matters – non-preparation of consolidated Financial Statements
- Pension increase – no evidence to confirm conformance with statute

Consistent with prior-years, my Audit Report is also modified to report that without group consolidation the Financial Statements have not been prepared in accordance with all relevant laws and policies.

However the following two qualifications reported in 2015/16 are cleared as follows:

- Basic Island Pension – satisfactory evidence has been secured to support the accuracy of expenditure on this social benefit
- Bulk Fuel Installation – classification of reserves and authorisation of expenditure and has been resolved through the establishment of the BFI Special Fund

NEW ISSUES

The following new issues arise in respect of the financial year 2016/17 and cause modification of my Auditor's Report. These new issues are expanded in the main body of my Management Letter and principally the section on significant matters arising from the audit which remain unresolved.

VALUATION OF INFRASTRUCTURE ROADS

As explained in Note 9.3.5.4 a management assessment was made of the value of roads infrastructure to be recognised at cessation of transitional provisions under IPSAS 17 *Property Plant and Equipment*. Management was unable to provide sufficient appropriate evidence to confirm the basis for initial recognition at fair value or depreciated cost of the roads infrastructure at 31 March 2017. Since I was unable to apply alternative audit procedures to obtain the evidence required, I have added the asset class roads infrastructure to my scope limitation qualification relating to the airport and wharf infrastructure valuation.

STATEMENT OF SPECIAL FUNDS

The class of Special Funds – Projects in Note 11.15.2.1 were established by Order to enable individual projects to be accounted for separately to the Consolidated Fund. At the 31 March 2017 the DFID Project Fund reports an overdrawn balance of £3.328m, the DFID Infrastructure Fund reports a balance in-hand of £2.297m and the EDF Projects fund a balance in-hand of £1.386m. It appears that misallocations may have occurred in the recognition of capital expenditure and earmarked grant funding between these funds which may date back some years and cannot easily be identified and corrected by management.

I was unable to secure adequate appropriate evidence regarding the transactions and balances on these Special Funds, either from management or by using alternative audit procedures. In these circumstances, I am unable to determine whether any adjustments are necessary to the Special Fund balances in Note 11.15.2.1 and reported in the Statement of Financial Position.

MATERIAL UNCERTAINTY ON GOING CONCERN

The economic conditions in St Helena are such that SHG would be unable to function in its current form without continued bi-lateral support in the form of UK Aid funding. The existence of the three-year funding agreement, in the form of a Memorandum of Understanding, gives a commitment in principle through to 31 March 2019 and underpins management's use of the going concern basis of accounting. However the absence of a clear position on the level of funding for 2018/19 gives rise to a material uncertainty. My Report is therefore modified, without qualification, to draw attention to this matter.

EXPENDITURE IN EXCESS

Expenditure was incurred during 2016/17 on specific heads in excess of statutory authority. The Statement of Expenditure in Excess presented at the 19 December 2017 meeting of Legislative Council as sessional paper 40/2017 did not reflect the final outturn position for 2016/17 at the close of the Financial Statements and a revised Statement of Excess was laid on 23 March 2018.

Until the revised Statement is examined by PAC and properly authorised through the Section 106 procedure this excess expenditure does not conform to the statutory authority that governs it. I am therefore required to report a regularity qualification.

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.

However, I have identified further misstatements, with potential for material effect, which remain uncorrected. Further work would be required to quantify more precisely their impact on the Financial Statements. These unadjusted misstatements are described in the section on unresolved matters below and are detailed in Appendix C.

SIGNIFICANT ISSUES ARISING FROM THE AUDIT

SIGNIFICANT QUALITATIVE ASPECTS OF ACCOUNTING PRACTICE

FINANCIAL REPORTING FRAMEWORK

Section 10(1) of the Ordinance requires that the annual Financial Statements of Government comply with the IPSAS. The Financial Statements for the year 2016/17 are the sixth year of reporting on an accruals basis using IPSAS. The matters reported in this Management Letter relate to the draft 2016/17 Financial Statements submitted for audit in September 2017.

The basis of preparation of the Financial Statements as set out in Note 9.1 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 2016/17 the separate Financial Statements of SHG are again presented without group consolidation.

BASIS OF PREPARATION

The accounting policies disclosed in Note 9.2 are in accordance with IPSAS except for those recognised areas of non-compliance in terms of IPSAS 6 *Consolidated and Separate Financial Statements,* as explained above.

The transitional provisions enjoyed by SHG for the five-year period from first time adoption of IPSAS in 2011/12 expired at 31 March 2016. Accordingly the Financial Statements for 2016/17 require full recognition of public assets in accordance with IPSAS 17 *Property Plant and Equipment,* and leasehold interests in accordance with IPSAS 13 *Leases*, and accounting for non-exchange transactions including taxation in accordance with IPSAS 23 *Revenue from Non-exchange Transactions*.

In overall terms, and notwithstanding the continued audit qualifications and difficulties in their preparation, these Financial Statements have maintained the trend of improvement in presentation and disclosure in accordance with the IPSAS financial reporting framework.

GOING CONCERN

The SHG recurrent budget for 2016/17 originally set at £36.311m was planned to be 62% funded through direct financial support from Department for International Development (DFID). I have therefore considered management's assessment that SHG, as an economic reporting entity is a going concern.

The commitment of United Kingdom (UK) aid to St Helena through DFID in the form of non-budget financial support and technical cooperation is set out in a memorandum of understanding (MOU) covering the three year period 1 April 2016 through to 31 March 2019.

The DFID support for the 2016/17 financial year was initially committed at £22.500m and subsequently increased to £23.732m in Amendment Letter No.1. The DFID support for the 2017/18 budget was outlined in Amendment Letter No.2 at £28.7m being core funding of £23.500m and £5.200m for the RMS and contractual commitments for shipping and fuel.

In determining whether the going concern basis of preparation remains appropriate management are required to look at minimum 12 months from the date of approval of the Financial Statements. This requires management and the auditor to look at the proposed commitment of UK Aid funding for the forward period 2018/19.

The economic conditions in St Helena are such that SHG is unable to function without continued bi-lateral support in the form of UK Aid funding. The existence of the three-year MOU gives a commitment to funding in principle through to 31 March 2019 and underpins management's use of the going concern basis of accounting. However the absence of a clear position on the level of funding for 2018/19, in the context of depleted general reserves, gives rise to a material uncertainty.

Where a material uncertainty related to going concern is adequately disclosed, ISA 570 *Going Concern* requires the auditor to express an unqualified opinion but with a separate section to emphasise the disclosure of the material uncertainty related to going concern.

SIGNIFICANT DIFFICULTIES ENCOUNTERED DURING THE AUDIT

DELAYED PRODUCTION OF ACCOUNTS

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.

Due to a combination of technical accounting challenges and limited internal capacity within Corporate Finance the draft Financial Statements due in mid-July were not submitted to the Audit Office in complete and auditable form until 12 September 2017. The delay in the preparation of the 2016/17 Financial Statements has adversely impacted the overall reporting timeline and accordingly the DFID requirement to report audited accounts by 31 December 2017 has not been met.

The slippage of the audit reporting from final quarter of 2017 into the first quarter of 2018 has attendant consequences – not least the other financial planning routines and estimates preparation for the 2018/19 financial year which have pressurised the audit closure and extended the turnaround of requests for information. Validating the fair value estimates for land and buildings following cessation of transitional provisions had attendant challenges.

Nonetheless, the requirement in Section 109(2) of the Constitution, for the Chief Auditor to audit the accounts within six-months of receipt or such longer time as the Governor may direct, will be achieved – more specifically Her Excellency the Governor has granted an extension until 30 March 2018.

VALUATION OF THE CROWN ESTATE

The cessation of transitional provisions since first time adoption of IPSAS required SHG to account for the value of the Crown Estate within the 2016/17 Financial Statements. Capital expenditure incurred since 1 April 2011 has been recognised in the accounts as forming part of property plant and equipment – this already accounted for assets in the amount of £240.346m within Statement of Financial Position and related Note 11.7.

However previously excluded from the accounts and therefore requiring valuation were those assets already held by SHG prior to 1 April 2011. As explained in Note 9.3.5 SHG commissioned a professional valuation of Crown Land and Buildings from DH Hall Chartered Surveyors and separately a valuation of the RMS St Helena from CW Kellock & Co Ltd. For roads infrastructure value at initial recognition is based upon a management estimate. In consequence a further £58.521m of assets together with accumulated depreciation of £25.288m have been recognised in the 2016/17 Financial Statements.

The cessation of transitional provisions and process of valuation and subsequent audit of these numbers represents a significant additional requirement in the reporting of the Financial Statements compliant with the IPSAS framework. I identified the valuation of public assets as representing a significant risk in my audit of the Financial Statements. I applied audit procedures responsive to the identified risk to satisfy myself on the valuation assumptions and methodology used to determine a fair value of the public assets to be recognised in the Financial Statements. I have reported the errors and subsequent adjustments identified at audit within the section on significant issues resolved with management.

SIGNIFICANT MATTERS ARISING FROM THE AUDIT WHICH REMAIN UNRESOLVED

Each of the issues leading to a modification of my Independent Auditor's Report were discussed with management together with a range of other significant matters. These unresolved matters are summarised in this section.

VALUATION OF INFRASTRUCTURE

Aid funded infrastructure in respect of the airport, permanent wharf and roads amounting to £235.992m at 31 March 2017 (£217.640m at 31 March 2016) reported within Property Plant and Equipment in Note 11.7, 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 9.3.5 to the Financial Statements, there is a high degree of estimation uncertainty in using 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 aid funded airport wharf and roads infrastructure. The revenues recognised as non-exchange infrastructure aid funding are equally affected.

As also explained in Note 9.3.5.4 a management assessment was made of the value of roads infrastructure to be recognised at cessation of transitional provisions under IPSAS 17. Management was unable to provide sufficient adequate evidence to confirm the basis for initial recognition of the roads infrastructure at nil net book value.

The Financial Secretary previously advised an intention to commission a formal valuation of these infrastructure assets as at the date of operational readiness as a basis for future depreciation. The procurement process failed to identify a suitable expert to undertake this specialist valuation exercise. To obtain an independent expert assessment of replacement cost before the required audit reporting deadline remains impractical. In these circumstances, there is a practical limitation of scope presented by management that causes a qualification of the audit opinion on fair presentation.

TECHNICAL COOPERATION PROJECTS SPECIAL FUND

In my Management Letter for 2015/16 I drew attention to two dormant Special Funds which carry deficit balances and require attention by management. In my further enquiries into these matters I am of the view that previous expenditure in the amount of £0.230m booked to the Technical Cooperation Projects Fund did not meet the purpose of that fund in that the expenditure was ineligible for DFID project funding. Accordingly this expenditure is deemed misstated and should be charged upon the Consolidated Fund. This matter is included within the statement of unadjusted errors in Appendix C.

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. However, 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.

In my previous Management Letter I reported that the information provided to the Governor in support of the decision to increase pensions appeared deficient. The situation identified in 2015/16 also pertains to 2016/17 where the official advice given to the Governor makes no reference to the pay rates applicable to the general public service. Specifically, there is no mention of the 2.75% pay award made to public officers when recommending the 4.74% pensions increase effective from 1 April 2016.

Section 29(b)(i)(B) of the Ordinance 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. Consistent with 2015/16 I have again qualified my regularity opinion in that I was unable to obtain sufficient appropriate evidence that the 2016/17 pensions increase made under section 17 amounting to some £50,000, and payable from the Consolidated Fund, conforms to the statutory authority that governs it.

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.

PROVISION FOR LITIGATION

In accordance with IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* the Financial Statements are required to recognise a provision where there is a constructive obligation arising from a past event and it is probable that an outflow of resources will be required to settle the associated liability of uncertainty and amount.

SHG continue to be engaged in several on-going legal proceedings at reporting date for which insufficient provision had been made in the draft Financial Statements. The reality of the situation was evidenced when court judgements against SHG awarded compensation well in excess of that provisioned at the previous accounting date.

Based upon review of the pending cases the provision of £0.352m at 31 March 2017 appeared to be materially understated. Management have now assessed the probability of economic outflows and a reasoned estimate for the accounting provision has been included in the Financial Statements increasing the provision in Note 11.13 to £4.831m. The required increase in provision is represented by a Litigation Reserve in Note 11.15.1.8 and forming part of the Consolidated Fund.

PROPERTY PLANT AND EQUIPMENT

From my review of assets under construction I noted that a range of assets transferred to completed assets were in fact not complete or handed over to SHG at 31 March 2017. These assets included the new Bulk Fuel Installation £19.142m, the Aviation Fuel Facility £1.581m and a significant section of the Haul Road £9.193m. Management have now reclassified these expenditures as assets under construction in Note 11.7 Property Plant and Equipment.

RECOGNTION OF LAND AND BUILDINGS

The process adopted by management for initial recognition of Land and Buildings upon cessation of transitional provisions was unnecessarily complex and resulted in a range of material errors which required correction.

To simplify the accounting and eliminate the errors identified the professional valuation was taken as the basis for initial recognition of land and buildings as a restatement adjustment upon cessation of IPSAS 17 and therefore presenting restated opening balances at 31 March 2016 as permitted in the Standard. The restatement adjustments are now correctly presented in the Restatement Note 9.4 and the Property Plant and Equipment Note 11.7.

TRANSFER FROM CURRENCY FUND

Two separate matters arose in regard to transfers between the Currency Fund and the General Revenue of SHG. These separate matters relate to transfers under Section 17(d) and 17(c) of the Currency Ordinance as set out in the following sections.

Section 17(d) of the Currency Ordinance provides that:

> *(d) if at the end of any financial year the General Reserve exceeds 10% of the liabilities of the Fund, the Commissioners, with the approval of the Governor acting in his or her discretion, may direct that the amount in excess of the said 10% is to be transferred in whole or in part to the General Revenue of St Helena*.

The balance on the Currency Fund General Reserve at 31 March 2017 exceeded 10% of the demand liabilities but no request of was made of the Governor during the year 2016/17 to make any transfer. Instead on 18 August 2017 the Financial Secretary sought approval for a transfer of £0.5m to have retrospective effect so that it may be booked within the SHG and Currency Fund accounts for 2016/17.

Notwithstanding any point of lawfulness on the retrospective application of a direction made by the Governor under section 17(d), from an accounting perspective two types of events are identified in IPSAS 14 *Events after the Reporting Date*:

> *(a) Those that provide evidence of conditions that existed at the reporting date (adjusting events after the reporting date); and*
>
> *(b) Those that are indicative of conditions that arose after the reporting date (non-adjusting events after the reporting date).*

In applying the IPSAS 14 it becomes clear that the requested transfer £0.5m from Currency Fund to Consolidated Fund is discretionary rather than obligating and was not a condition that existed at the reporting date. Moreover the standard requires that any dividend or similar distribution declared after the reporting date shall not be recognised as a liability at the reporting date. Such dividends or distributions are included in the notes in accordance with IPSAS 1 *Presentation of Financial Statements*.

Management have accepted that the direction under section 17(d) must by definition be a non-adjusting post-balance sheet event and accordingly the £0.5m transfer booked in the draft accounts of the Currency Fund and Consolidated Fund has been reversed.

Section 17(c) does however provide that:

> *(c) any remaining surplus must be transferred to the General Revenue of St Helena, but the Governor may direct that further allocation to the General Reserve may be made out of such remaining surplus;*

In terms of this provision a retained surplus was reported on the Currency Fund at 31 March 2017 of £29,907 which, in the absence of any direction from the Governor to the contrary, must be transferred to the General Revenue of St Helena Government. In this case there is an automatic statutory requirement for this transfer to be made in the 2016/17 accounts from the Currency Fund to the General Revenues of SHG. Accordingly management have processed this amendment.

ENTERPRISE ST HELENA

Expenditure on support to Enterprise St Helena amounting to £1.407m was initially classified as Other Expenditure rather than as Payments to Other Agencies, Bodies or Persons with the Analysis of Expenditure by Category in Note 10.2. The misclassification has been corrected by management.

BIOLOGICAL ASSETS

Consideration was given to the application of IPSAS 27 *Agriculture* in relation to the Crown Forests. Management asserted that the Crown Forests are primarily held for service potential being either recreational or environmental purposes in addition to providing forest products to the community. Management further asserted that proceeds from sale of timber will be offset by harvesting costs and accordingly the forest stand will have limited commercial value as an agricultural asset under this standard. I have accepted the non-recognition of biological assets in accordance with accounting policies but further work is required to estimate the commercial value of agricultural assets managed by SHG.

> ***Recommendation 1*** *The Financial Secretary should perform a technical accounting review of the Crown Forest to estimate the commercial value of the plantation for potential recognition of an agricultural asset under IPSAS 27.*

RECLASSIFICATIONS

There have been some material adjustments processed by management with audit agreement to correctly classify items of account in the Financial Statements as disclosed in Appendix B Table 2. The material item is set out in the paragraph below.

INVESTMENT PROPERTY

Property which had been initially recorded and disclosed as investment property in Note 11.8 in the amount of £5.025m at 31 March 2017 was subsequently reclassified as PPE in Note 11.7 since these properties are held for their service potential rather than for commercial investment. IPSAS 17 also requires that if there is a high level of judgment involved in classifying assets as either Investment Property or PPE, disclosures regarding the judgements considered should be made in the Financial Statements. The required adjustments have been processed by management.

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

These other matters of significance arise from my audit responsibilities under the ISAs and local statute which are directly relevant to those charged with governance in overseeing the financial reporting process.

In subsequent sections I deal with the Annual Governance Statement and matters of financial management and internal control which are relevant to my responsibilities for reporting significant control deficiencies and improving accountability in the public administration of St Helena.

COMPLIANCE WITH FINANCIAL REPORTING FRAMEWORK

Section 10(1) of the 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 9.1 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 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 reported, in the section 'on other matters required by statute', that the Financial Statements have not been prepared in accordance with all relevant laws.

EXPENDITURE WITHOUT AUTHORITY

The Statement of Comparison of Budget and Actual Amounts and related Note 10.3 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 2016/17 there are three heads of recurrent expenditure and one head of capital expenditure which are reporting Expenditure in Excess:

Recurrent Expenditure

- **Corporate Support, Policy and Planning** – Overspend of £22,161 on a budget of £1.355m equivalent to 1.6%
- **Health** – Overspend of £110,996 on a budget of £5.070m equivalent to 2.2%
- **Environment and Natural Resources** – Overspend of £133,333 on a budget of £3.100m equivalent to 4.2%

Capital Expenditure

- **Health** – Overspend of £72,821 on a budget of £43,000 equivalent to 170%

A revised Statement of Expenditure in Excess is to be laid before LegCo on 23 March 2018 and referred to PAC for examination and reporting in accordance with Section 106. Until that scrutiny and approval process is complete such Expenditure in Excess does not conform with the statutory authority that governs it. In these circumstances I am required to qualify my opinion on regularity in my Independent Auditor's Report under section 29(1)(b)(i)(B).

WITHDRAWAL WARRANTS

Section 104 of the Constitution provides that the Governor, acting on recommendation of the Financial Secretary and with approval of Executive Council, may issue a Withdrawal Warrant authorising the limitation or suspension of appropriated expenditure, to the extent specified in the warrant. Given these Withdrawal Warrants are issued by the Governor in an executive capacity the Constitution requires these are laid at the next session of Legislative Council for notification purposes.

Note 10.3 to the Financial Statements provides an analysis of the changes between original and final budgets appropriated from the Consolidated Fund. During the 2016/17 financial year Withdrawal Warrants amounting to £1.229m were issued to help finance other expenditures appropriated by Council.

The following two Withdrawal Warrants were duly executed but were not laid before LegCo as required by section 104(2) of the Constitution:

- Withdrawal Warrant issued on 12 January 2017 in the amount of £0.865m and relating to the Second Supplementary Appropriation Ordinance
- Withdrawal Warrant issued on 31 March 2017 in the amount of £0.350m and relating to the Third Supplementary Appropriation Ordinance

Notwithstanding the breach in notification procedure I am nevertheless persuaded that these warrants issued prior to the year-end were valid and therefore did have the desired effect to reduce the amount appropriated under those heads specified in the warrants.

> ***Recommendation 2*** *The Financial Secretary should establish internal arrangements to ensure due compliance with statutory and regulatory requirements in the financial administration of St Helena.*

WRITTEN REPRESENTATIONS

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

ANNUAL GOVERNANCE STATEMENT

Consistent with best practice SHG has prepared an Annual Governance Statement (AGS) for 2016/17 for publication with the Financial Statements. In accordance with ISA 720, *The Auditor's Responsibilities Relating to Other Information,* I am obliged to read the AGS and consider whether the reported content is not inconsistent with my understanding 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 from my review and discussed with management:

- The Head of Internal Audit was unable to form an opinion on risk management governance and internal control for inclusion in the AGS – further comment on the adequacy of internal audit coverage is made in the section on internal control below.
- The section on Significant Governance Issues was inconsistent with my understanding of the issues pertaining to the financial year – some significant governance issues were omitted including the delay in the commencement of scheduled air services and the unexpected depletion of government reserves.

Revisions were subsequently made by management such that the published 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 review.

In my 2012/13 Management Letter issued in October 2015, 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 – this was not achieved.

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 Financial Accounts Memorandum. I have summarised in the Appendix D the six audit recommendations made in this Letter.

STATUTORY BASIS FOR FINANCIAL CONTROL

The statutory basis for financial control in St Helena, as interpreted by management, is on a modified cash basis, whereby the statutory basis for financial reporting is on an accruals basis in accordance with IPSAS. The relevant statutory underpinning is set out in the financial provisions of the Constitution and the Ordinance.

The attendant differences between these two bases presents particular difficulties when it comes to reporting on budget and actual amounts in the context of appropriated expenditures and revenues and the reported statutory Financial Statements. These differences are resolved to an extent in terms of transparent financial reporting through the inclusion of Statement of Comparison of Budgeted and Actual Amounts presented on a modified cash basis in the Financial Statements pursuant to IPSAS 1 *Presentation of Financial Statements*.

However the management of the financial affairs of Government on these two different bases is becoming cumbersome and inefficient. The transparency and understandably that may reasonably be expected in public sector financial reporting is not being achieved at present.

The planned move to accruals budgeting for 2019/20 will address the root cause of these difficulties by putting financial control and financial reporting on the same accounting basis. However it is clear that the statutory underpinning for securing effective financial control and informative and reliable financial reporting will need consequential updating and specifically the relevant provisions of the Constitution and Ordinance.

> ***Recommendation 3*** *The Financial Secretary should review the relevant statutory provisions for financial control and financial reporting purposes and propose legislative amendments in preparation for the implementation of accruals budgeting in 2019/20.*

MANAGEMENT OF RESERVES

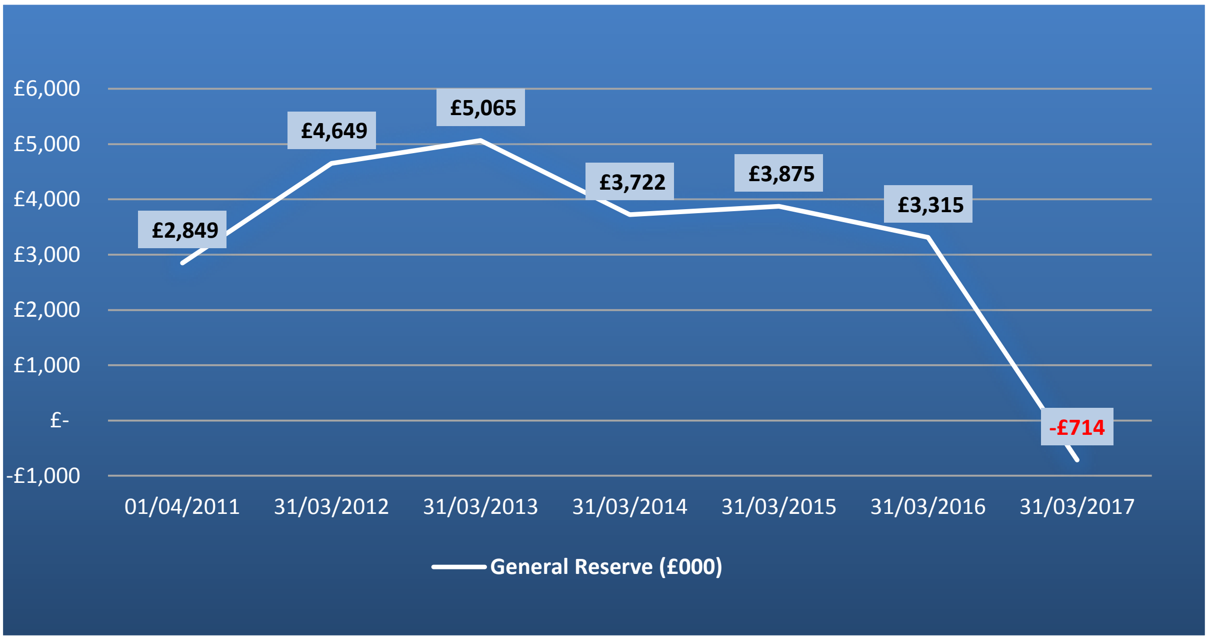
There is statutory authority for SHG to maintain two forms of reserve funds, these being the Consolidated Fund as disclosed in in Note 11.15.1, and Special Funds as disclosed in note 11.15.2. The Consolidated Fund comprises eight reserves – the General Reserve is unrestricted and therefore represents the usable reserve of SHG; the other seven reserves are restricted being either earmarked for a particular purpose or required for specific accounting purposes under IPSAS.

GENERAL RESERVE

The recovery of arrears in financial reporting has enabled the Financial Secretary to get an improved fix on the financial position of SHG. Indeed in the completion of the draft Financial Statements for 2016/17 it became apparent that the General Reserve had become significantly depleted within the last financial year.

The unrestricted balance on the Consolidated Fund as at 1 April 2016 was £3.1m – this being the General Reserve as reported in Note 11.15.1.1 to the Financial Statements. However, with a withdrawal from the Consolidated Fund of £1.5m to support the hotel project and a significant deficit arising on normal operations in 2016/17 of some £1.9m (before audit adjustments) the General Reserve was found to be completely depleted and presenting an overdrawn balance at 31 March 2017. The Figure 1 below charts the balance on the General Reserve since first time reporting under IPSAS from 1 April 2011.

FIGURE 1 DEPLETION IN GENERAL RESERVE



In view of her special responsibilities for financial management, the Governor, ExCo and DFID were duly informed and Corporate Finance prepared an objective analysis of the unexpected depletion in the General Reserve – the main reasons are echoed here for the purpose of improving transparency and accountability for public funds:

- **Backlog in financial reporting** – meant that decisions were taken without knowledge of the true financial position or performance for the year.
- **Unexpected calls on the Consolidated Fund** – these included damages awarded by the court which were in excess of the provisioning set aside for settlement and demand led service expenditure.
- **Financial management capacity and capability** – these extend across the entire organisation both at directorate and corporate finance level.
- **Ineffective financial systems and controls** – internal financial control systems were not being effectively maintained at directorate or corporate level.

The Financial Secretary has proposed measures to strengthen financial management capacity and establish adequate and effective internal control systems. DFID have also performed an independent financial management review with recommendations for improvement.

There is a commitment to replenish depleted reserves and ensure that working balances are sufficient to protect against future exogenous shocks. The adequacy of the previous minimum reserves balance of £1.25m has been reconsidered with a proposal that the General Reserve should be maintained at £3.0m – the PAC had previously recommended that the level of reserve balances should be underpinned by a technical rationale.

OTHER NEGATIVE RESERVES

In relation to the other reserves forming the Consolidated Fund I draw attention to two further reserves which are reporting negative balances at 31 March 2017 these being the Pensions Reserve and the Litigation Reserve.

The Pension Reserve in Note 11.5.1.4 represents the unfunded liability for the defined benefits pension scheme. As described more fully in Notes 9.2.10.1 and 9.3.1 the £68.776m liability at 31 March 2017 is an actuarially assessed measure of the present cost of meeting future pension obligations under the scheme. Since the scheme has no assets the cost of pensions in payment fall upon the Consolidated Fund on a pay-as-you-go basis in accordance with the Pensions Ordinance.

The Litigation Reserve in Note 11.5.1.8 represents the unfunded liability associated with a provision established for litigation and claims expected to be settled by SHG in future periods. The present value of the liability at 31 March 2017 is reported at £4.520m. Since there is no cash-backing to this reserve the settlement of subsequent claims will need to be paid from the Consolidated Fund and will require appropriation at that time.

FINANCIAL MANAGEMENT CAPACITY

The delay in the preparation of Financial Statements, the extent of the errors and adjustments required, and the continuing audit qualifications – including significant limitations of scope and areas of non-compliance with statute, and indeed the unexpected financial outturn for 2016/17 are symptomatic of an underlying capacity issue within the financial administration of SHG. But there are also opportunities for improved efficiency (timeliness) and quality (accuracy) through automation of the statutory accounts production process and introduction of quality assurance protocols.

The Financial Secretary has similarly identified capacity limitations within Corporate Finance but these equally extend through to Directorate level and specifically accounting and financial management support to designated Accounting Officers. There is an evident case for the development of a financial management improvement programme to enhance capacity and skills across SHG to include Corporate Finance and Directorates.

> ***Recommendation 4*** *SHG should develop and implement a financial management improvement programme with resource requirements to build financial management capacity and capability across Government.*
>
> ***Recommendation 5*** *The Financial Secretary should seek to improve efficiency and accuracy in the statutory accounts production process through automation and quality assurance protocols.*

ADEQUACY OF INTERNAL AUDIT

An adequate and effective government internal audit function operating to the public sector internal audit standards provides an assurance to management on compliance with policies and procedures and the effectiveness of the framework of internal control.

The SHG internal audit plan for 2016/17 was not completed due substantially to staff turnover and therefore inadequate resources directed to the planned audits. Furthermore, some unplanned work caused other programmed activities to be deferred. The Head of Internal Audit concluded there was insufficient internal audit work completed to support an evidence-based opinion on governance, risk management and internal control for the year 2016/17.

The inability to form such an opinion represents a significant gap in internal assurance to management for the purposes of reporting the Annual Governance Statement. In process terms it also means that the required Internal Audit Standards were not met.

SHG has recognised the deficiency in internal assurance and has taken steps to address the resourcing of the internal audit function and enable technical improvements supported through the UKOT audit and oversight project. The Audit Committee has been assured that corrective actions are in hand and the situation is not expected to recur in 2017/18.

FOLLOW-UP OF PREVIOUS ISSUES

Audit recommendations made in previously issued Management Letters for 2011/12 through 2015/16 were followed-up with management. The current status of these recommendations is summarised 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 is planned to be introduced but with implementation delayed 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** – Whilst the EDF financing agreement notes that finances provided are subject to standard auditing procedures these are not expressly designed to give assurance on EDF.
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 be measured in the AGS.	**Pending** – Whilst guidance to officers was updated in July 2017 I am advised that no formal Code of Corporate Governance has yet been published to provide a 'comply or explain' framework for reporting.
Recommendations from 2013/14 and 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.	**In progress** – I am advised that all files have been reviewed and are in process of evidencing.

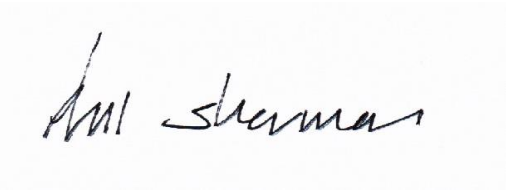
Recommendation	Follow-up status
5. SHG should procure the services of an independent and qualified professional valuer to determine the replacement cost value of the Airport and Wharf Infrastructure	**Pending** – I am advised that Corporate Finance plans to procure the services of a professional surveyor to determine the value of public infrastructure. However the initial procurement exercise proved unsuccessful.
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** – I am advised that Corporate Finance plan for staged consolidation for the 2017/18 reporting year following completion of the entity accounts.
Recommendations from 2015/16	
7. 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.	**Closed** – I am advised that advice to the Governor regarding the pension increase for 2017/18 is now compliant with section 17.
8. 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.	**Pending** – I am advised that a commentary on the prudential impact of proposed pension increases is to be considered in the future.
9. SHG should secure from DFID legal transfer of aid funded assets to the ownership of SHG and update the asset register accordingly.	**In progress** – I understand that Corporate Finance plan to complete the formal transfer before the 2017/18 financial year end**.**
10. 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.	**In progress** – I am advised that Corporate Finance are reviewing these funds and analysing movements on a monthly basis. Historical balances are being reviewed including those relating to Special Funds – Projects.

The recommendation to introduce accruals budgeting was made in the 2011/12 Management Letter but implementation will not be seen until 2019/20 – some seven years subsequent. In other areas specific audit recommendations remain pending from year to year and, notwithstanding the evident capacity issues, are taking too long to resolve. To address this matter I recommend that the Financial Secretary develops an action plan with identified resources to respond to outstanding Management Letter recommendations.

> ***Recommendation 6*** *The Financial Secretary should develop an action plan linked to identified resources to address outstanding Management Letter recommendations.*

CONCLUDING REMARKS

I acknowledge and thank the officers of St Helena Government, and in particular the Corporate Finance team, for their assistance and co-operation given to the Saint Helena Audit Service during the course of the statutory audit for 2016/17.



Phil Sharman
Chief Auditor for St Helena
St Helena Audit Service

29 March 2018

TO THE MEMBERS OF LEGISLATIVE COUNCIL

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the Financial Statements of St Helena Government (SHG), which comprise the statement of financial position as at 31 March 2017, and the statement of financial performance, statement of changes in net assets and reserves, statement of cash flows, and statement of comparison of budget and actual amounts, for the year then ended, and notes to the Financial Statements, including a summary of significant accounting policies.

In my opinion, except for the effects of the matters described in 1 and 2 below, the accompanying Financial Statements present fairly, in all material respects, the financial position of SHG as at 31 March 2017, and its financial performance and its cash flows for the year then ended in accordance with International Public Sector Accounting Standards (IPSAS).

Basis for Qualified Opinion

1. ***Infrastructure Valuation***

Aid funded infrastructure amounting to £236.992m at 31 March 2017 (£217.640m at 31 March 2016) reported within Property Plant and Equipment in the Statement of Financial Position, and forming part of infrastructure, roads infrastructure and assets under construction in Note 11.7, is measured on an earned value basis – being the cost of works completed under the current contract. IPSAS 17, *Property Plant and Equipment* and IPSAS 23, *Non-Exchange Transactions* require that such aid funded assets and related revenues are measured at replacement cost. Note 9.3.5 explains there is a high degree of estimation uncertainty associated with the valuation of the airport, wharf and roads infrastructure.

As also explained in Note 9.3.5 management assessed the value of roads infrastructure, to be recognised at cessation of transitional provisions under IPSAS 17, at nil net book value, being cost less accumulated depreciation. Management was unable to provide sufficient adequate evidence to confirm the basis for initial recognition of the roads infrastructure at nil value.

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:

(i) the use of an estimate based on earned value; and,
(ii) the initial recognition of roads infrastructure at nil value

would give rise to a material misstatement, and whether any adjustment was necessary to the reported value of Property, Plant and Equipment in Note 11.7 and associated reserves in the Statement of Financial Position, and to the recognition of Non-Exchange Infrastructure Aid Funding in the Statement of Financial Performance.

2. Special Funds

Note 11.15.2.1 reports the balances and movements on Special Funds established by order to enable individual projects to be accounted for separately to the Consolidated Fund. I was unable to secure adequate appropriate evidence regarding the transactions and balances on the DFID Project Fund at £3.328m overdrawn, and the DFID Infrastructure Fund at £2.297m in-hand, and the EDF Projects Fund at £1.386m in-hand at 31 March 2017, either from management or by using alternative audit procedures. In these circumstances, I am unable to determine whether any adjustments are necessary to Special Fund balances in Note 11.15.2.1 and reported in the Statement of Financial Position.

I conducted my audit in accordance with International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of my report. I am independent of SHG in accordance with the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (IESBA Code) and I have fulfilled my other ethical responsibilities in accordance with the IESBA Code. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Material Uncertainty Related to Going Concern

I draw attention to Note 9.1.2 in the Financial Statements which indicates that SHG is reliant on recurrent funding through UK grant-in-aid for the continued operation of public services in St Helena. Whilst there is a documented commitment by DFID to provide financial assistance for the three-year period 1 April 2016 through to 31 March 2019 the amount of grant-in-aid for the final year to 31 March 2019 has yet to be finalised. In the absence of sufficient grant-in-aid and with depleted usable reserves SHG would not be in a position to meet its liabilities as they fall due within the foreseeable future without significant curtailment of services. As stated in Note 9.1.2 these circumstances indicate that a material uncertainty exists which may cast doubt on SHG's ability to continue as a going concern. My opinion is not modified in respect of this matter.

Other Information

Management is responsible for other information. The other information includes the Financial Secretary's Report and the Annual Governance Statement but does not include the Financial Statements and my audit report thereon. My opinion on the Financial Statements does not cover the other information and I do not express any form of assurance or conclusion thereon.

In connection with my audit of the Financial Statements my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Financial Statements or my knowledge obtained in the audit or otherwise appears to be materially misstated. If based on the work I have performed I conclude there is a material misstatement of this other information I am required to report the fact. I have nothing to report in this regard.

Key Audit Matters

Key audit matters are those matters that, in my professional judgment, were of most significance in my audit of the Financial Statements of the current period. These matters were addressed in the context of my audit of the Financial Statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters.

Except for the matters described in the above sections on Basis for Qualified Opinion, and Material Uncertainty Relating to Going Concern, I have identified the following key audit matter to communicate in my report.

Valuation of Public Assets

The cessation of transitional provisions since first time adoption of IPSAS required SHG to account for the value of public assets within the Financial Statements. Previously excluded from the accounts under transitional provisions and therefore requiring valuation were those assets held by SHG prior to 1 April 2011.

I identified the valuation of public assets as representing a significant risk in my audit of the Financial Statements due their materiality and estimation uncertainty involved. I applied audit procedures responsive to the identified risk which focussed upon the qualifications of the management expert, the reasonableness of the valuation assumptions used, and suitability of the methodology applied to determine a fair value of the public assets to be recognised.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the Financial Statements in accordance with IPSAS, and for such internal control as they determine is necessary to enable the preparation of Financial Statements that are free from material misstatement, whether due to fraud or error.

In preparing the Financial Statements, management is responsible for assessing SHGs ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting.

Those charged with governance are responsible for overseeing SHGs financial reporting process.

Auditor’s Responsibilities for the Audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the Financial Statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Financial Statements.

I also 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.

A further description of the auditor's responsibilities for the audit of the Financial Statements is located at Annex A. This description forms part of my auditor's report.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Auditor's Other Responsibilities arising from Law and Regulation

Section 29(1)(b)(i) of the Public Finance Ordinance requires me to assess whether in all material respects the expenditure and income have been applied to the purposes intended and conform to the authorities which govern them; and whether the accounts and Financial Statements have been prepared in accordance with all relevant laws and policies.

Qualified Opinion on Regularity

In my opinion, except for the matters described in 3 and 4 below, in all material respects the expenditure and income has been applied to the purposes intended, and conforms to the authorities which govern them.

Basis for Qualified Opinion on Regularity

3. ***Excess Expenditure***

For 2016/17 Legislative Council authorised total budgeted expenditure from:

- Head 12: Corporate Support Policy and Planning of £1,355,000
- Head 23: Health of £5,070,000 (recurrent) and £43,000 (capital)
- Head 26: Environment and Natural Resources of £3,100,000

As summarised in the Note 10.3 to the Financial Statements the actual expenditures on these heads were £1,377,161, £5,180,996, £72,821 and £3,233,555 respectively, resulting in expenditure in excess of authority amounting to £22,161, £110,996, £133,555 and £72,821 respectively.

4. ***Pensions Increase***

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 4.74% with effect from 1 April 2016 contained no reference to the decision to award a 2.75% 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.

Adverse Opinion on Other Matters Required by Statute

In my opinion, because of the significance of the statutory non-compliance described in 5 below, the Financial Statements have not been prepared in accordance with all relevant laws or policies.

Basis for Adverse Opinion on Other Matters Required by Statute

5. ***Group Financial Statements***

Section 10(1) of the Public Finance Ordinance requires the Financial Statements to be prepared in a manner consistent with the IPSAS. IPSAS require an explicit and unreserved statement of compliance to be made. As disclosed in Note 9.1 and contrary to the requirements of IPSAS 6, *Consolidated and Separate Financial Statements*, SHG has not prepared consolidated Financial Statements for the economic entity that incorporate the results of the entire group.

Phil Sharman
Chief Auditor CA CPFA

St Helena Audit Service
Post Office Building, Jamestown, St Helena Island, South Atlantic Ocean, STHL 1ZZ

28 March 2018

ANNEX A TO THE INDEPENDENT AUDITORS REPORT

Further description of the auditor's responsibilities for the audit of the financial statements

As part of an audit in accordance with ISAs, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of SHG's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on SHG's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause SHG to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

I also provide those charged with governance with a statement that I have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on my independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, I determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. I describe these matters in my auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in my report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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 9.4 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	
2016/17	**Dr £'000**	**Cr £'000**	**Dr £'000**	**Cr £'000**
Assets under construction	29,986			
Infrastructure		20,723		
Infrastructure - Roads		9,193		
Motor vehicles		70		
Being correction of assets under construction (BFI, Access road) prematurely transferred to completed assets				
Expenses (Legal Claims)				41
Litigation Reserve	4,520			
Provisions				4,479
Being correction of provisions understated				
Payments to Other Agencies, Bodies or Persons			1,407	
Other expenditure				1,407
presentational change to ensure comparability between 15/16 and 16/17 in respect of monies paid out to ESH				
Revenue (Other Treasury Receipts)			500	
Payables (Deposits: Currency Fund)	500			
Being the reversal of the transfer of £500k from the Currency Fund's to the SHG's Consolidated Fund.				

Adjusted misstatement	Statement of Financial Position		Statement of Financial Performance	
2016/17	**Dr £'000**	**Cr £'000**	**Dr £'000**	**Cr £'000**
Accrue income (other)	557			
Trade & Other receivables		557		
Being adjustment to rectify BFI receivable incorrectly eliminated (presentational change to Note 11.4)				
Payables	860			
EDF reserves		860		
Being reversal of EDF special fund restatement journal				
Payable	730			
Other Development Aid (EDF)				730
To recognise the reallocation of EDF funds from TDC to SHG				
Trade & Other receivables	417			
Accrued Income		417		
Being adjustment to correct misclassification identified within the receivables note				
Impairment			1,023	
Land and buildings		1,023		
Being impairment of buildings already recognised in the Financial Statements at the end of IPSAS 27 transitional provisions (2015/16)				
Land and buildings	4,538			
Movement on non-current assets				4,538
Being reversal of the devaluation of assets at the end of the IPSAS transitional provisions (2015/16)				

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 9.4 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	
2016/17	**Dr £'000**	**Cr £'000**	**Dr £'000**	**Cr £'000**
Property, plant and equipment	5,025			
Investment property		5,025		
Being reclassification of assets previously classified as investment property now identified as strategic assets under PPE				

Table 3: Material adjustments to financial note disclosures

Description of correction	Note affected	Value of the error £'000
Changes made to Statement of Financial Performance (Expenditure) so that expenditure agrees to supporting note 10.2 (Expenditure by Category)	Note 4 Statement of Financial Performance	4,520
Changes made to the Cash Flow Statement (Investment in Subsidiary) to include £1.5m (iro SHHDL)	7.0 Statement of Cash Flows	1,500
Changes made to the cash flow statement (Proceeds from the Sale of Non-current Assets) to remove non-cash item of £0.6m (iro SHHDL)	7.0 Statement of Cash Flows	600
Changes made to Statement of Financial Performance (Expenditure) so that expenditure agrees to supporting note 8.1 (Statement showing each head of expenditure)	8.1 Statement showing each head of expenditure paid out of and each category of revenue accruing to the Consolidated Fund and Special Funds	870
Changes made to Note 9.1 to separately disclose: • Changes in accounting policy regarding cessation of transitional provisions and • Going concern note on the material uncertainty	9.1 Basis of Preparation	Narrative
Changes made to Note 9.2 to remove details of valuations and methodology from this note and correctly disclose it under Note 9.3 (Key Estimation Assumptions)	9.2 Principal Accounting Policies	Narrative
Changes to the revenue recognition accounting policy note in line with IPSAS 23 which requires accruals basis accounting	9.2.12 – Revenue and expenditure recognition	Narrative
Disclosure of section 9.3.6 Fair Value Estimation with sub-sections on each class with information about professional valuers and assumptions applied in arriving at estimates of fair value	9.3 Key Estimation Assumptions	Narrative
Changes made to Note 9.4 Restatement of Prior Period Figures to include: • type of restatement i.e. the amount relating to cessation of the transitional provisions in respect of tax revenues and the initial recognition of assets • removal of restatement relating to the Special Funds - Projects	9.4 Restatement of Prior Period Figures	Narrative

Description of correction	Note affected	Value of the error £'000
Changes made to Note 10.3 (Comparison of Budget and Actual Amounts) to separate appropriated and not appropriated to reconcile to Note 8.0 (Statement of Comparison of Budget and Actual). As well as removal of a line item associated with litigation claims	10.3 Comparison of Budget and Actual Amounts	Narrative
Disclosure of the maximum exposure to credit risk as a result of a £1m financial guarantee with BOSH.	11.16 Nature and Extent of Risks arising from Financial Instruments	Narrative
Disclosure of the maximum exposure to credit risk as a result of a £1 million financial guarantee contract with BOSH.	11.16 Nature and Extent of Risks arising from Financial Instruments	Narrative
Inclusion of disclosures required by IPSAS 17 in respect of revaluations such as information about valuer and assumptions applied in arriving at estimates of fair value.	11.7 Property, plant and equipment	Narrative
Changes to the PPE Note 11.7 to recognise that at the end of the IPSAS 27 transitional provisions on 31 March 2016 the deemed cost for land and buildings was the valuation provided by DM Hall not cost. This resulted in the derecognition of a significant balance previously credited to the revaluation reserve.	Note 11.7 -Property, Plant and Equipment Note 11.15.1.3 - Revaluation reserve	7,677
Changes made to Note 13: ● To correctly state the value of project expenditure claims made by Connect. ● To correctly reflect the results and net assets of Solomon and Co.	According to Note 13 – Controlled entities	• Narrative • 3,130
Several changes were made to the Financial Secretary's Report to tie up the reported figures and tables to the Financial Statements.	1.0 - Financial Secretary's Report	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 or in aggregate.

Management have adjusted the Financial Statements for all misstatements identified at the audit other than the following:

- Potential material adjustments arising from the valuation of airport, wharf and roads infrastructure on a replacement cost basis – the financial effect cannot be quantified until a professional valuation report is secured
- Errors arising from disagreement with management – these errors are scheduled in Table 1 and 2 below
- Extrapolated errors from audit testing – the financial effect of these projected soft errors are scheduled in Table 1 below

Table 1: Uncorrected misstatements in the main Financial Statements

Uncorrected misstatements	Statement of Financial Position		Statement of Financial Performance	
Pertaining to current year	**Dr £'000**	**Cr £'000**	**Dr £'000**	**Cr £'000**
Payables Expenses *Soft error projections from audit testing affecting the above items.*	67		67	
Consolidated Fund Special Fund DfiD Technical Cooperation *Clearance of deficit in SF for which no funds were appropriated.*	230	230		
Payables - CF Inventory *Being adjustment to reflect correct treatment of Currency Fund coin packs.*	38	38		

Table 2: Uncorrected disclosure misstatements

Description of uncorrected disclosure	Note affected	Value of the error £'000
Some leases included under the 'non-operational' asset category of the leases schedule provided were not disclosed in the Financial Statements.	Note 11.10 Leases	38

No	Observation	Recommendation	Priority
1	Management have asserted that the Crown Forest is primarily held for service potential being either recreational or environmental purposes in addition to providing forest products to the community. Accordingly no biological asset is recognised in accordance with current accounting policies.	The Financial Secretary should perform a technical accounting review of the Crown Forest to estimate the commercial value of the forest plantation for potential recognition of an agricultural asset under IPSAS 27.	M
2	The need to confirm compliance with law and regulation was evidenced by two Withdrawal Warrants not being notified to LegCo as required by section 104(2) of the Constitution.	The Financial Secretary should establish internal arrangements to ensure due compliance with statutory and regulatory requirements for the financial administration of St Helena.	H
3	The statutory basis for financial control in SHG is on a modified cash basis whereby the statutory basis for financial reporting is on an accruals basis in accordance with IPSAS. The management of the financial affairs of government on these two different bases is proving cumbersome and inefficient.	The Financial Secretary should review the relevant statutory provisions for financial control and financial reporting purposes and propose legislative amendments in preparation for the implementation of accruals budgeting in 2019/20.	M
4	The delay in the preparation of Financial Statements, extent of the errors and adjustments required, continuing audit qualifications, and unexpected financial outturn are symptomatic of an underlying capacity issue within the financial administration of SHG.	SHG should develop and implement a financial management improvement programme with resource requirements to build financial management capacity and capability across Government.	M
5	There is scope for improving efficiency and accuracy in the accounts production process through the use of new technology and quality assurance measures.	The Financial Secretary should seek to improve efficiency and accuracy in the statutory accounts production process through automation and quality assurance protocols.	M
6	Follow-up of recommendations in prior year Management Letters indicate that these are taking too long to resolve.	The Financial Secretary should develop an action plan linked to identified resources to address outstanding Management Letter recommendations.	M

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 Financial Statements of the SHG Group or the internal control arrangements of component entities.