

The Annual Audit Letter for London Borough of Sutton

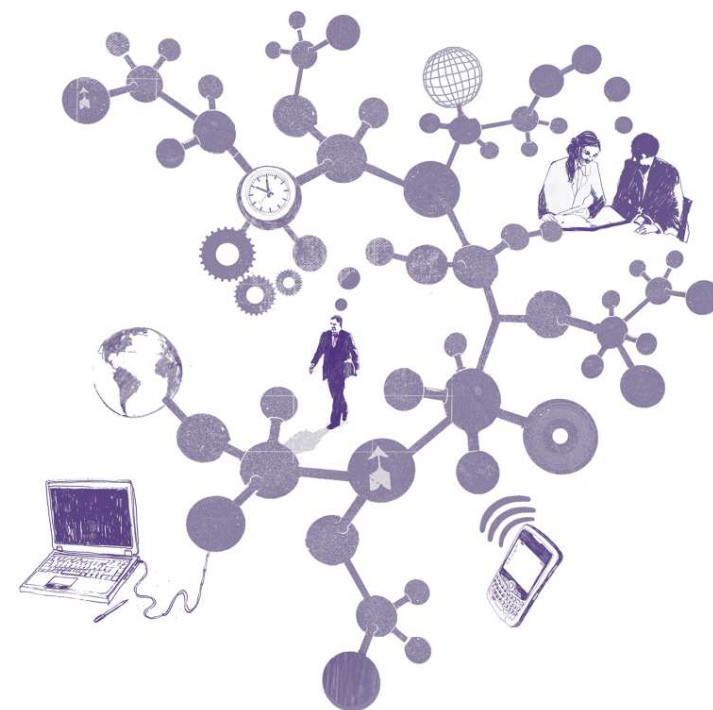
Year ended 31 March 2016

October 2016

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Executive summary

Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at the London Borough of Sutton (the Council) for the year ended 31 March 2016.

This Letter is intended to provide a commentary on the results of our work to the Council and its external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice (the Code) and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'.

We reported the detailed findings from our audit work to the Council's Audit Committee as those charged with governance in our Audit Findings Report on 22 September 2016.

Our responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council's financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council's financial statements, we comply with International Standards on Auditing (UK and Ireland) (ISAs) and other guidance issued by the NAO.

Our work

Financial statements opinion

We gave an unqualified opinion on the Council's financial statements on 29 September 2016.

Value for money conclusion

We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources during the year ended 31 March 2016. We reflected this in our audit opinion on 29 September 2016.

Whole of Government Accounts

We completed work on the Council's consolidation return following guidance issued by the NAO and issued an unqualified report on 29 September 2016 .

Certificate

We certified that we had completed the audit of the accounts of the London Borough of Sutton in accordance with the requirements of the Code on 29 September 2016.

Certification of grants

We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. Our work on this claim is not yet complete and will be finalised by 30 November 2016. We will report the results of this work to the Audit Committee in our Annual Certification Letter.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's staff.

Grant Thornton UK LLP
October 2016

Audit of the accounts

Our audit approach

Materiality

In our audit of the Council's accounts, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for our audit of the Council's accounts to be £9,729,000, which is 2% of the Council's gross revenue expenditure. We used this benchmark, as in our view, users of the Council's accounts are most interested in how it has spent the income it has raised from taxation and grants during the year.

We set a lower threshold of £486,000, above which we reported errors to the Audit Committee in our Audit Findings Report.

Pension Fund

For the audit of the London Borough of Sutton Pension Fund accounts, we determined materiality to be £5,068,000, which is 1% of the Fund's net assets. We used this benchmark, as in our view, users of the Pension Fund accounts are most interested in the value of assets available to fund pension benefits.

We set a lower level of specific materiality for certain areas such as cash and cash equivalents, management expenses and related party transactions.

The scope of our audit

Our audit involves obtaining enough evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error.

This includes assessing whether:

- the Council's accounting policies are appropriate, have been consistently applied and adequately disclosed;
- significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the narrative report and annual governance statement to check they are consistent with our understanding of the Council and with the accounts on which we give our opinion.

We carry out our audit in line with ISAs (UK and Ireland) and the NAO Code of Audit Practice. We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Council's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the accounts Council

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk
<p>Management over-ride of controls</p> <p>Under ISA (UK&I) 240 it is presumed that the risk of management over-ride of controls is present in all entities.</p>	<p>As part of our audit work we have:</p> <ul style="list-style-type: none"> • Tested journal entries. • Reviewed accounting estimates, judgements and decisions made by management. • Reviewed unusual significant transactions. <p>We did not identify any issues to report.</p>
<p>Valuation of pension fund net liability</p> <p>The Council's pension fund asset and liability as reflected in its balance sheet represent significant estimates in the financial statements.</p>	<p>As part of our audit we have:</p> <ul style="list-style-type: none"> • Documented the key controls that were put in place by management to ensure that the pension fund liability was not materially misstated. • Walked through the key controls to assess whether they were implemented as expected and mitigate the risk of material misstatement in the financial statements. • Reviewed the competence, expertise and objectivity of the actuary who carried out the Council's pension fund valuation. • Gained an understanding of the basis on which the IAS 19 valuation was carried out, undertaking procedures to confirm the reasonableness of the actuarial assumptions made. • Reviewed the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial report from your actuary. • Tested the data provided to the actuary. <p>We did not identify any issues to report.</p>
<p>Valuation of property, plant and equipment</p> <p>The Council undertakes a rolling revaluation programme of its land and buildings.</p>	<p>As part of our audit we have:</p> <ul style="list-style-type: none"> • Identified the controls put in place by management to ensure that the carrying value of property, plant and equipment was not materially different from fair value at year end. • Reviewed the consistency of the financial statements with the valuation report from the valuer. • Undertook procedures to confirm the reasonableness of the proposed revaluations, including reference to national trends. • Tested the data provided to the valuer. <p>Our sample testing of assets revalued in the year identified that the revaluation of one asset had been incorrectly applied to the component of the asset rather than the main asset. As a result of this finding, the Council reviewed their revaluation processes and identified 23 assets where the impact of revaluation during the year was misstated, resulting in a net overstatement of the value of Property, Plant and Equipment and Investment Properties by £58.832m.</p>

Audit of the accounts – Pension Fund

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work on the audit of the pension fund.

Risks identified in our audit plan	How we responded to the risk
<p>Management over-ride of controls</p> <p>Under ISA (UK&I) 240 it is presumed that the risk of management over-ride of controls is present in all entities.</p>	<p>As part of the audit we have:</p> <ul style="list-style-type: none">• Tested journal entries.• Reviewed accounting estimates, judgements and decisions made by management.• Reviewed unusual significant transactions.
<p>Level 3 Investments – Valuation is incorrect</p> <p>Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.</p>	<p>As part of the audit we have:</p> <ul style="list-style-type: none">• Updated our understanding of the processes and controls in place to estimate the valuation of these assets.• Tested a sample of valuations by obtaining and reviewing the audited accounts at the latest date for individual investments and agreeing these to the fund manager reports at that date. Reconciliation of those values to the values at 31st March with reference to known movements in the intervening period.• Reviewed the nature and basis of estimated values and consideration of the assurance management has over the year end valuations provided for these types of investments.• Reviewed the competence, expertise and objectivity of management experts used.• Reviewed the qualifications of the fund managers as experts to value the level 3 investments at year end and gaining an understanding of how the valuation of these investments was reached.

Audit of the accounts

Audit opinion

We gave an unqualified opinion on the Council's accounts on 29 September 2016, in advance of the 30 September 2016 national deadline.

The Council made the accounts available for audit in line with the agreed timetable. Not all accompanying working papers were provided at this time, however they were provided quickly when subsequently re-requested. Response to audit queries was generally within the agreed timescales and where difficulties were encountered, the finance team were very proactive in following up outstanding requests.

Issues arising from the audit of the accounts

We reported the key issues from our audit of the accounts of the Council to the Council's Audit Committee on 22 September 2016. Property, Plant and Equipment (PPE) remains a challenging area. We encountered difficulties in testing additions and disposals as the working papers initially provided did not agree to the Council's financial statements. The finalisation of the revaluation of PPE was taking place during the audit. As the Council closes down its accounts more efficiently ahead of the statutory deadline for audited accounts moving forward in 2017/18, this will be a key area to complete much earlier.

We also identified issues regarding the completeness and accuracy of data in the fixed asset register.

The Council are currently undertaking a cleansing exercise on the fixed asset register and are aiming to have this completed by 31 December 2016.

A cumulative material adjustment of £58,832k was made to the value of Property Plant and Equipment (£52,015k) and Investment Property (£6,817k) balances as the revaluation of assets was applied to the components of the asset rather than the main asset on the Council's fixed asset register.

Pension fund accounts

We also reported the key issues from our audit of accounts of the Pension Fund hosted by the Council to the Council's Audit Committee on 22 September 2016. There were no amendments to the Council's Pension Fund accounts that impacted on the net asset position of the fund.

Annual Governance Statement and Narrative Report

We are also required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website with the draft accounts in line with the national deadlines. Both documents were prepared in line with the relevant guidance and were consistent with the supporting evidence provided by the Council and with our knowledge of the Council.

Whole of Government Accounts (WGA)

We carried out work on the Council's consolidation schedule in line with instructions provided by the NAO. We issued a group assurance certificate which did not identify any issues for the group auditor to consider.

Other statutory duties

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts. We have not had to use any of these additional powers.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice (the Code), following the guidance issued by the NAO in November 2015 which specified the criterion for auditors to evaluate:

In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work.

The key risks we identified and the work we performed are set out in table 2 overleaf.

Overall VfM conclusion

We are satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2016.

Value for Money

Table 2: Value for money risks

Risk identified	Work carried out	Findings and conclusions
<p>Financial sustainability and savings plans</p> <p>The Council has historically managed its finances well and has consistently achieved its planned savings targets. It achieved a balanced budget for 2015/16 and has set a balanced budget for 2016/17. However, following the most recent settlement, the scale of efficiencies and savings required is still sizeable.</p>	<p>We undertook the following procedures:</p> <ul style="list-style-type: none"> • Reviewed the Council's progress in updating its medium term financial plan. • Reviewed reports to Members. • Reviewed the savings plans for 16/17 and 17/18. • Met with key officers to discuss the major strategic challenges and the Council's proposed response. 	<p>The Council has a very good recent history of dealing with change in its financial environment, and after successfully completing 2015/16 with a £0.7m underspend, it is fully implementing and continuing to develop its MTFP for the period to 2019/20.</p> <p>The Council have set a balanced 2016/17 budget through a mixture of savings, adopting a 1.99% rise in council tax for 2016/17 and through using a small amount of reserves.</p> <p>There remains a budget gap during the period of the MTFP as a result of a challenging funding settlement from central government and cost and volume pressures in a number of key service areas. Members and officers have a strong understanding of the constrained areas and solutions are continually being developed. The Council is committed to achieving transformational service change and delivering savings via its Smarter Sutton programme. Part of this is manifested in closer working with local NHS bodies and the continued development of alternative delivery models with local authorities in the South West London area.</p> <p>Members and officers recognise that in the very near future difficult decisions will need to be made as regards service provision, so that the recent trend of strong financial performance and delivery of recurrent financial savings can be continued.</p> <p>On that basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements to achieve Value for Money in its use of resources.</p>

Working with the Council

Our work with you in 2015/16

We are really pleased to have worked with you over the past year. We have established a positive and constructive relationship. Together we have delivered some great outcomes.

An efficient audit – we delivered the accounts audit before the deadline and in line with the timescale we agreed with you, despite the challenges with Property, Plant and Equipment. Our audit team are knowledgeable and experienced in your financial accounts and systems. Our relationship with your team provides you with a financial statements audit that continues to finish ahead of schedule releasing your finance team for other important work.

Improved financial processes – during the year we reviewed your financial systems and processes including employee remuneration, non-pay expenditure and property plant and equipment. We made recommendations to improve controls over your fixed asset register.

Understanding your operational health – through the value for money conclusion we provided you with assurance on your operational effectiveness for meeting your future financial challenges.

Sharing our insight – we provided regular audit committee updates covering best practice. Areas we covered included Innovation in public financial management, Knowing the Ropes – Audit Committee; Effectiveness Review, Making devolution work, Reforging local government.

We have also shared with you our insights on advanced closure of local authority accounts, in our publication "Transforming the financial reporting of local authority accounts" and will continue to provide you with our insights as you bring forward your production of your year-end accounts.

Thought leadership – We have shared with you our publication on Building a successful joint venture and will continue to support you as you consider greater use of alternative delivery models for your services.

Providing training – we delivered training on the effectiveness of the Audit Committee to your March 2016 Committee. provided a presentation your teams with training.

Supporting development – we provided workshops for senior finance officers on financial accounts and annual reporting.

Providing information – We provided you with access to CFO insights, our online analysis tool providing you with access to insight on the financial performance, socio-economy context and service outcomes of councils across the country.

Working with the Council

Working with you in 2016/17 Highways Network Asset

The Code of Practice on Local Authority Accounting (the Code) requires authorities to account for Highways Network Asset (HNA) at depreciated replacement cost (DRC) from 1 April 2016. The Code sets out the key principles but also requires compliance with the requirements of the recently published Code of Practice on the Highways Network Asset (the HNA Code), which defines the assets or components that will comprise the HNA. This includes roads, footways, structures such as bridges, street lighting, street furniture and associated land. These assets should always have been recognised within Infrastructure Assets.

The Code includes transitional arrangements for the change in asset classification and the basis of measurement from depreciated historic cost (DHC) to DRC under which these assets will be separated from other infrastructure assets, which will continue to be measured at DHC.

This is expected to have a significant impact on the Council's 2016/17 accounts, both in values and levels of disclosure, and may require considerable work to establish the opening inventory and condition of the HNA as at 1 April 2016.

Under the current basis of accounting values will only have been recorded against individual assets or components acquired after the inception of capital accounting for infrastructure assets by local authorities. Authorities may therefore have to develop new accounting records to support the change in classification and valuation of the HNA.

The nature of these changes means that Finance officers will need to work closely with colleagues in the highways department and potentially also to engage other specialists to support this work.

Some of the calculations are likely to be complex and will involve the use of external models, a combination of national and locally generated rates and a number of significant estimates and assumptions.

We have been working with the Council on the accounting, financial reporting and audit assurance implications arising from these changes. We have issued two Client Briefings which we have shared with your finance team. We will issue further briefings during the coming year to update the Council on key developments and emerging issues.

This significant accounting development is likely to be a significant risk for our 2016/17 audit, so we have already had some preliminary discussions with the Council to assess the progress it is making in this respect. Our discussions with Council Officers to date has highlighted the Council are utilising a standard national model and are liaising with neighbouring Council's to ensure that methodology and accounting treatment is consistent.

Working with the Council

We will continue to liaise closely with the senior finance team during 2016/17 on this important accounting development, with timely feedback on any emerging issues.

The audit risks associated with this new development and the work we plan to carry out to address them will be reflected in our 2016/17 audit plan.

We will also continue to work with you and support you over the next financial year. Locally our focus will be on:

- **An efficient audit** – continuing to deliver an efficient audit. We hold on-going meetings with senior officers in your finance team and we will continue to build on the good progress in streamlining the financial statements preparation and audit.
- **Improved financial processes** – we will focus our work on reviewing the progress you are making on strengthening management arrangements over budget setting and delivery of financial savings programmes. We will continue to monitor your financial position.
- **Understanding your operational health** – we will focus our value for money conclusion work on reviewing the progress implementing your Medium Term Financial Plan plans and keeping up to date with proposed alternative delivery models and plans to merge back office services with neighbouring Councils.

Appendix A: Reports issued and fees

We confirm below our final fees charged for the audit and **provision of non-audit services**

Fees

	Planned £	Actual fees £	2014/15 fees £
Statutory audit of Council	94,920	TBC*	125,720
Statutory audit of Pension Fund	21,000	21,000	21,000
Housing Benefit Grant Certification	12,300	TBC**	20,900
Total fees (excluding VAT)	128,220	TBC	167,620

* The scale fee for the audit was £94,920 and we budgeted on a recovery of 60% which we considered a reasonable rate of recovery and typical of the recovery we would normally expect. Our actual recovery was 46% as a result of the additional work undertaken and delays with testing and finalising Property Plant and Equipment additions, disposals and revaluations and working through several amendments to the Whole of Government Accounts Return.

The additional fee of £10,000 would bring the recovery up to 52% to provide us with a reasonable return and we consider this an appropriate additional fee. We have therefore absorbed some of the over-run ourselves as continued commitment in our ongoing relationship.

The completion of our testing was delayed due to issues encountered with PPE and Whole of Governments Accounts return. We are still confirming the final fee with management. We anticipate that the additional fee will be approximately £10,000.

** The proposed audit fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA). The fee for grant certification will be confirmed on completion of our work in this area in November 2016

Fee variations are subject to approval by Public Sector Audit Appointments Ltd.

Reports issued

Report	Date issued
Audit Plan	March 2016
Audit Findings Report	September 2016
Annual Audit Letter	October 2016

Fees for other services

Service	Fees £
Audit related services	
Independent Assurance of Teachers' Pensions return	6,000
Independent Assurance of GLA Decent Homes backlog funding*	TBC
Independent Assurance of pooling of housing capital receipts claim	2,800
Non-audit services	
None	Nil

* We have not yet agreed with the Council terms of engagement in relation to this piece of work.



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