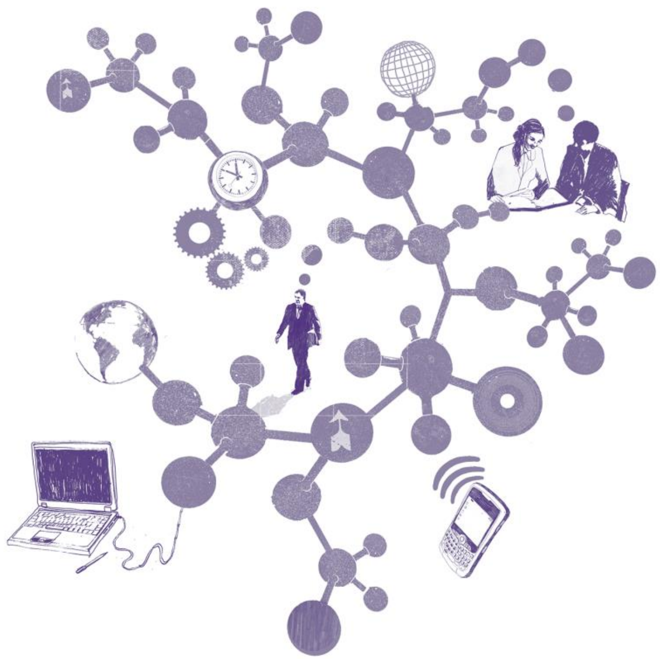
The Annual Audit Letter for the London Borough of Croydon

Year ended 31 March 2016

October 2016



Paul Grady
Engagement Lead
T 020 7728 2301
E Paul.D.Grady@uk.gt.com

Chris Long
Engagement Manager
T 020 7728 3295
E Chris.Long@uk.gt.com

Rufaro Dewu
Support Manager
T 020 7728 3240
E Rufaro.K.Dewu@uk.gt.com

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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 Croydon for the year ended 31 March 2016.

This Letter is intended to provide a commentary on the results of our work to you and your 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 your General Purposes and Audit Committee as those charged with governance in our Audit Findings Report on 14 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 your financial statements (section two)
- assess your arrangements for securing economy, efficiency and effectiveness in your use of resources (the value for money conclusion) (section three).

In our audit of your 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 your financial statements on 29 September 2016.

Value for money conclusion

We were satisfied that you put in place proper arrangements to ensure economy, efficiency and effectiveness in your 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 your consolidation return following guidance issued by the NAO and issued an unqualified report on 19 October 2016.

Certificate

We are currently unable to certify that we have completed the audit of the accounts of the London Borough of Croydon as we have not yet given an audit opinion on the pension fund annual report.

Certification of grants

We also carry out work to certify your 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 General Purposes and 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 your staff.

Grant Thornton UK LLP
October 2016

Audit of the accounts

Our audit approach

Materiality

In our audit of your 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 your accounts to be £22,505,000, which is 1.95% of your gross revenue expenditure. We used this benchmark, as in our view, users of your 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 £1,000,000, above which we reported errors to your General Purposes and Audit Committee in our Audit Findings Report.

Pension Fund

For the audit of the London Borough of Croydon Pension Fund accounts, we determined materiality to be £8,759,000, 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.

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:

- your 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 you 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 your 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
The revenue cycle includes fraudulent transactions Under ISA (UK&I) 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.	Having considered the risk factors set out in ISA240 and the nature of your revenue and expenditure streams, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • there is little incentive to manipulate revenue recognition; • opportunities to manipulate revenue recognition are very limited; • the culture and ethical frameworks of local authorities, including yourselves, mean that all forms of fraud are seen as unacceptable. **We did not identify any issues to report.**
Management over-ride of controls Under ISA (UK&I) 240 it is presumed that the risk of management over-ride of controls is present in all entities.	As part of our audit work, we have carried out the following: • Review of control environment and internal processes in place in relation the posting of journal entries; • Review of accounting estimates, judgments and decisions made by management; • Testing of journal entries; • Review of unusual significant transactions. **We did not identify any issues to report.**
Valuation of property, plant and equipment You revalue your assets on a rolling basis. The Code requires that you ensure the carrying value at the balance sheet date is not materially different from current value. The valuation techniques applied by your valuation experts represents a significant estimate in the financial statements.	As part of our audit work, we have carried out the following: • Review of the competence, expertise and objectivity of management experts used; • Testing of revaluation movements made during the year to ensure they are consistent with underlying valuer information and have input correctly into your asset register; • Review of your processes and assumptions for the calculation of the estimate; • Review of the instructions issued to valuation experts and the scope of their work; • Discussions with your valuer about the basis on which the valuation is carried out and challenge of the key assumptions; • Evaluation of the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value. **We did not identify any issues to report.**

Audit of the accounts – Council (continued)

Risks identified in our audit plan	How we responded to the risk
Valuation of pension fund net liability Your pension fund asset and liability as reflected in its balance sheet represent significant estimates in the financial statements.	As part of our audit work, we have carried out the following: • Identify the controls put in place by management to ensure that the pension fund liability is not materially misstated. Assess whether these controls were implemented as expected and whether they are sufficient to mitigate the risk of material misstatement; • Review the competence, expertise and objectivity of the actuary who carried out your pension fund valuation and gain an understanding of the basis on which the valuation is carried out; • Undertake procedures to confirm the reasonableness of the actuarial assumptions made; • Review the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial report from your actuary. **We did not identify any issues to report.**
Employee remuneration Employee remuneration and benefit obligations and expenses understated (Remuneration expenses not correct)	As part of our audit work, we have carried out the following: • Identification of controls over employee remuneration; • Walkthrough of the employee remuneration cycle; • Testing the year end reconciliation of payroll expenditure recorded in the general ledger to the subsidiary system; • Testing to confirm the completeness of payroll transactions. **We did not identify any issues to report.**
Operating expenses Creditors related to core activities understated or not recorded in the correct period (Operating expenses understated)	As part of our audit work, we have carried out the following: • Documented our understanding of processes and key controls over the transaction cycle; • Undertaken walkthrough of the key controls to assess the whether those controls were in line with our documented understanding; • Testing the year end reconciliation of operating expenditure recorded in the general ledger to the subsidiary system; • Unrecorded liabilities testing to assess whether transactions are recorded in the correct period; • Substantive testing of operating expenditure payments; • Substantive testing of year end payable balances. **Our audit work identified an error of £20k within Operating expenses which has been extrapolated to £3.277m. This extrapolated error was not material to the financial statements. We did not identify any further issues to report.**

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
The revenue cycle includes fraudulent transactions Under ISA (UK&I) 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.	Having considered the risk factors set out in ISA240 and the nature of your revenue streams, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • there is little incentive to manipulate revenue recognition; • opportunities to manipulate revenue recognition are very limited; • the culture and ethical frameworks of local authorities, including the London Borough of Croydon as the administering authority, mean that all forms of fraud are seen as unacceptable. **We did not identify any issues to report.**
Management over-ride of controls Under ISA (UK&I) 240 it is presumed that the risk of management over-ride of controls is present in all entities.	As part of our audit work, we have carried out the following: • Review of accounting estimates, judgments and decisions made by management; • Testing of journal entries; • Review of entity controls; • Review of unusual significant transactions. **We did not identify any issues to report.**
Level 3 Investments – Valuation is incorrect 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.	As part of our audit work, we have carried out the following: • We gained an understanding of the transaction including a review of supporting documentation. • We carried out walkthrough tests of the controls identified in the cycle. • Tested a sample of investments by obtaining and reviewing the audited accounts at latest date for individual investments and agreeing these to the fund manager reports at that date. Reconciliation of those values to the values at 31s March with reference to known movements in the intervening period. • Reviewed the qualifications of fund managers as experts to value the level 3 investments at year end and gain an understanding of how the valuation of these investments has been reached. • Reviewed the nature and basis of estimated values and considered what assurance management has over the year end valuations provided for these types of investments. • Reviewed the competence, expertise and objectivity of any management experts used.. **We did not identify any issues to report.**

Audit of the accounts – Pension Fund (continued)

Risks identified in our audit plan	How we responded to the risk
Investment purchases and sales Investment activity not valid. (Occurrence) Investment valuation not correct. (Valuation gross or net)	As part of our audit work, we have carried out the following: • We have performed a walkthrough to gain assurance that the in-year controls were operating in accordance with our documented understanding. • We have reviewed the reconciliation of information provided by the fund managers, the custodian and the Pension Fund's own records and sought explanations for variances • Tested a sample of purchases and sales to ensure they are appropriate. **We did not identify any issues to report.**
Investment values – Level 2 investments Valuation is incorrect. (Valuation net)	As part of our audit work, we have carried out the following: • We have performed a walkthrough to gain assurance that the in-year controls were operating in accordance with our documented understanding. • We have reviewed the reconciliation of information provided by the fund managers, the custodian and the Pension Fund's own records and sought explanations for variances • For direct property investments agreed values in total to valuer's report and undertaken steps to gain reliance on the valuer as an expert. **We did not identify any issues to report.**
Contributions Recorded contributions not correct (Occurrence).	As part of our audit work, we have carried out the following: • We have performed a walkthrough to gain assurance that the in-year controls were operating in accordance with our documented understanding. • Tested a sample of contributions to source data to gain assurance over their accuracy and occurrence. • Rationalised contributions received with reference to changes in member body payrolls and numbers of contributing pensioners and ensured that any unexpected trends were satisfactorily explained. **Our sample testing of six contributions from scheduled and admitted identified two errors totalling £139 within contributions which has been extrapolated to £760k. We had no further issues to report.**

Audit of the accounts – Pension Fund (continued)

Risks identified in our audit plan	How we responded to the risk
Benefits payable Benefits improperly computed/claims liability understated (Completeness, accuracy and occurrence)	As part of our audit work, we have carried out the following: • We have performed a walkthrough to gain assurance that the in-year controls were operating in accordance with our documented understanding. • Tested a sample of individual pensions in payment by reference to member files. • Rationalised pensions paid with reference to changes in pensioner numbers and increases applied in the year and ensured that any unusual trends were satisfactorily explained. **We did not identify any issues to report.**
Member Data Member data not correct (Rights and Obligations)	As part of our audit work, we have carried out the following: • We have performed a walkthrough to gain assurance that the in-year controls were operating in accordance with our documented understanding. • Controls testing over annual/monthly reconciliations and verifications with individual members. • Sample tested changes to member data made during the year to source documentation. **We did not identify any issues to report.**

Audit of the accounts

Audit opinion

We gave an unqualified opinion on your accounts on 29 September 2016, in advance of the national deadline.

The key messages arising from our audit of your financial statements are:

- the draft financial statements were submitted for audit on the 23 June. This represents an improvement in your closedown from last year, although significant efficiencies are required to enable you to meet the 31 May deadline in 2017/18;
- working papers were provided over the course of our audit. The underlying format of the working papers was appropriate and adequately set out, however, there were a number of delays and late adjustments to figures within working papers following submission to audit that caused delays;
- there have been delays in receiving responses for information from outside the core finance team. This has led to delays in our work and has reduced the efficiency of the audit process;
- there were a number of presentation and disclosure errors in the draft financial statements that we identified, which management has agreed to amend.

Issues arising from the audit of the accounts

We reported the key issues from our audit of the accounts to the General Purposes and Audit Committee on 14 September 2016.

Pension fund accounts

We also reported the key issues from our audit of accounts of the Pension Fund to the General Purposes and Audit Committee on 14 September 2016.

Annual Governance Statement and Narrative Report

We are also required to review your Annual Governance Statement and Narrative Report. You published them on your 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 management and with our knowledge of you.

Whole of Government Accounts (WGA)

We carried out work on your 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 your accounts and to raise objections received in relation to the accounts.

We had nothing to report in this respect.

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.

As part of our Audit Findings report agreed with you in September 2016, we agreed recommendations to address our findings. This included recommendations over controlling the demand led pressures within the People department and updating the HRA business planning to take into account the effect of rent reductions.

Overall VfM conclusion

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

Value for Money conclusion (continued)

Table 2: Value for money risks

Risk identified	Work carried out	Findings and conclusions
Medium term financial plans In line with many other authorities, your medium term financial planning identifies significant budget shortfalls over the coming years. You have set a balance budget for 2016/17, but this will require you to deliver significant savings through the Croydon Challenge programme and departmental savings of over £16m. Over the three year horizon from 2017/18 to 2019/20, you have already identified a further £14m of saving proposals, but will need to find another £26m over this period to close your budget gap. This does represent a reduction in projected budget gaps from last year. Progress continues to be made with council-wide transformation programmes and budget delivery alongside additional funding for Adult Social Care from the increase in Council Tax. However, the identification and delivery of substantial savings continues to be a risk to your overall financial health.	We followed up our findings from last year and review your arrangements over medium term financial planning. This included the reasonableness of significant assumptions around inflation, growth and savings as well as the impact of the Settlement Funding Assessment. We considered your plans to close the projected budget gap from 2017/18 to 2019/20, including identification of savings plans, arrangements for monitoring and managing delivery of budgets and the potential impact on service delivery.	Our summary findings were (further details are included in our Audit Findings Report); • 2015/16 outturn position of £1.2m underspend consisting of a significant departmental overspend of £8.5m (largely in demand led services), offset by non-departmental underspends of £9.7m. • For 2016/17, you have set a balanced budget, with generally robust underlying assumptions. • You have increased Croydon's share of council tax by 3.99% but, as service pressures are expected to grow, substantial efficiency and transformation savings will continue to be required across the organisation. • Medium term financial plans show narrowing of the budget gap to 2019/20 from £78m to £26m, but vigilance over the position and risks is still required to address future uncertainties. Longer term growth assumptions are lower than that experienced to date, so the forecast may need to be revised should growth exceed expectation **On the basis of the work performed, we concluded that the risk was sufficiently mitigated and you have proper arrangements**.

Value for Money conclusion (continued)

Table 2 (continued): Value for money risks

Risk identified	Work carried out	Findings and conclusions
Regeneration and growth You have ambitious plans to reshape Croydon through regeneration and growth. Working with partner organisations, the aim is to deliver more jobs, affordable homes and better infrastructure and facilities in the borough. You are pursuing innovative models of delivery, such as the Revolving Investment Fund to support schemes within your Growth Promise through funding outside the capital programme with minimal impact on the revenue budget. You have also formed a development company to deliver regeneration and provide homes. The plans for the borough are substantial and will require radical changes to the way in which you commission and deliver projects. The programme includes a number of key projects and investments, which are significant both in scale and financial terms.	We reviewed the project management and risk assurance frameworks established in respect of the more significant projects, to establish how you are identifying, managing and monitoring these risks. We reviewed progress made and significant developments in year, and the overall outcomes and expectations from the projects.	Our summary findings were (further details are included in our Audit Findings Report); • There are a number of substantial regeneration projects planned, the largest being Growth Zone which is supported by Central Government. The project will lead to significant growth opportunities in business rates as well as creating new jobs and at least 10,000 new homes. • The scale of the plans is far larger than anything attempted before, so it is critical they are well supported and well managed, with any delays having the potential to stall the wider growth. • Brick by Brick has been set up as a means by which you could help generate an additional supply of new homes, including affordable homes. This presents a mix of small and large scale projects, delivering homes, public realm, retail and leisure space. • Adequate governance arrangements are in place for both projects and you are seeking to mitigate risks arising from the issues noted with regard to Croydon Care Solutions. **On the basis of the work performed, we concluded that the risk was sufficiently mitigated and you have proper arrangements**.
Impact of policy changes on housing and welfare The Autumn Statement included a number of announcements intended to increase the availability and affordability of housing, including reduction in housing rents and right to buy changes. The reduction in rents will require significant savings to be made by the HRA. Demographic changes in the borough place additional demand on housing, welfare need and may impact homelessness. The plans and outcomes from the changes in government policy will be substantial both in terms of delivery of service and finances.	We reviewed your plans over the policy changes and actions proposed to resolve the financial implications of the schemes.	Our summary findings were (further details are included in our Audit Findings Report); • The HRA is expected to reduce rents by 1% p/a for the next 4 years, which contrasts with your longer term assumptions within the HRA's 30 year business plan. There is uncertainty around future legislative changes and the HRA business planning needs to be revised to take this into account. • You are responding to welfare reform and demographic change through the Gateway services. This has proven successful, and is expected to deliver financial benefit to the Council as well as residents. • However, there remains risk over the impact of further demand pressure as private rents rise and funding for Discretionary Housing Payments may fall. **On the basis of the work performed, we concluded that the risk was sufficiently mitigated and you have proper arrangements**.

Working with you

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.

Sharing our insight – we provided regular Audit, Governance and Standards Committee updates covering best practice. Areas we covered included**,** Knowing the Ropes – Audit Committee Effectiveness Review, Making devolution work, Reforging local government. We are also sharing 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 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 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.

Understanding your operational health – through the value for money conclusion we provided you with assurance on your operational effectiveness, the key findings of which are set out in this report.

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 your 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.

Working with you (continued)

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 are working with you on the accounting, financial reporting and audit assurance implications arising from these changes. We will issue further briefings during the coming year to update you 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 to assess the progress you are making in this respect.

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.

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	172,860	TBC	236,480
Statutory audit of Pension Fund	21,000	21,000	21,000
Housing Benefit Grant Certification	24,894	TBC	34,340
Total fees (excluding VAT)	**218,754**	**TBC**	**291,820**

Fees for other services

Service	Fees £
Non-audit services	
• Outline Business Case for Croydon Council and London Borough of Lambeth Legal Service Alternative Business Structure	31,433
• Financial Resilience Capacity Building 2016	3,500

Any amendments to the planned fees will be agreed at a later date.

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

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