Audit Findings

Year ending 31 March 2018

London Borough of Croydon

18 July 2018

Contents

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Headlines

This table summarises the key issues arising from the statutory audit of the London Borough of Croydon ('the Council') and the preparation of the Council and group's financial statements for the year ended 31 March 2018 for those charged with governance.

Financial Statements	Under the International Standards of Auditing (UK) (ISAs), we are required to report whether, in our opinion: • the Council and group's financial statements give a true and fair view of the Council and group's financial position and Council and group's expenditure and income for the year, and • have been properly prepared in accordance with the CIPFA/LASAAC code of practice on local authority accounting and prepared in accordance with the Local Audit and Accountability Act 2014. We are also required to report whether other information published together with the audited financial statements (including the Statement of Accounts, Annual Governance Statement (AGS) and Narrative Report), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.	Our audit work was completed on site during June and July 2018. Our findings are summarised on pages 4 to 16. We have identified a number of adjustments to the financial statements that are detailed in Appendix C. None of the adjustments identified have impacted on the reported deficit for the year or General Fund position for the Council. We have also raised recommendations for management as a result of our audit work in Appendix A. Our follow up of recommendations from the prior year's audit are detailed in Appendix B. Subject to outstanding queries being resolved, we anticipate issuing an unqualified audit opinion following the General Purposes and Audit Committee meeting on 18 July 2018, as detailed in the draft audit opinion accompanying this report. These outstanding items are summarised on page 4. We have concluded that the other information published with the financial statements, which includes the Statement of Accounts, Annual Governance Statement and Narrative Report, are consistent our knowledge of your organisation and with the financial statements we have audited.
Value for Money arrangements	Under the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report whether, in our opinion: • the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources ('the value for money (VFM) conclusion')	Our review of your value for money arrangements remains on-going and we will provide an update to the General Purposes and Audit Committee on our final conclusion. From our work completed so far, we have identified one matter that will impact on the final conclusion that we issue: In September 2017, Ofsted issued a report on the inspection of your services for children in need of help and protection that rated the Council as "inadequate". We therefore anticipate issuing a qualified 'except for' value for money conclusion, as detailed in the draft audit opinion accompanying this report. Our findings are summarised on pages 17 to 27.
Statutory duties	The Local Audit and Accountability Act 2014 ('the Act') also requires us to: • report to you if we have applied any of the additional powers and duties ascribed to us under the Act; and • certify the closure of the audit	We have not exercised any of our additional statutory powers or duties.

Acknowledgements

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team and other staff during our audit.

Summary

Overview of the scope of our audit

This Audit Findings report presents the observations arising from the audit that are significant to the responsibility of those charged with governance to oversee the financial reporting process, as required by International Standard on Auditing (UK) 260 and the Code of Audit Practice ('the Code'). Its contents have been discussed with the Chief Finance Officer.

As auditor we are responsible for performing the audit, in accordance with International Standards on Auditing (UK), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

Audit approach

Our audit approach was based on a thorough understanding of your business and is risk based, and in particular included:

- gaining an understanding of significant changes to the Group structure and obtaining supporting evidence to corroborate accounting transactions and disclosures within the financial statements;
- evaluation of identified components to assess the significance of each component and to determine the planned audit response based on a measure of the materiality and significance of the component as a percentage of the group's: current assets, total assets, current liabilities, total liabilities, equity, income and expenditure. A full scope, targeted or analytical approach was taken for each component based on their relative materiality to the group and our assessment of audit risk;
- full scope audit procedures on the Council, which represents 100% of the group's income, 100% of its expenditure and 93% of its net assets;
- issuing group instructions to our colleagues at Grant Thornton UK LLP in respect of their full scope audit of Brick By Brick Croydon Limited for the year ended 31 December 2017, using the results of their full scope audit together with additional follow-up audit procedures around work in progress expenditure for the period 1 January 2018 to 31 March 2018. Brick By Brick Croydon Limited represents 0% of the total income of the group, 0.007% of its expenditure and 7% of its total net assets.
- gaining an understanding of and evaluating the group's internal controls environment including its IT systems and controls; and
- substantive testing of the income, expenditure and net assets for each significant component. Testing undertaken covered 99.4% of group income, 99.9% of group expenditure and 99.6% of group assets and 98.5% of group liabilities..

Conclusion

We have substantially completed our audit of your financial statements and subject to outstanding queries being resolved, we anticipate issuing an unqualified audit opinion following the General Purposes and Audit Committee meeting on 18 July 2018, as detailed in the draft audit opinion accompanying this report. These outstanding items include:

- receipt and review of outstanding sample items for our testing of debtors, creditors, revenues, non-pay operating expenses and external schools payroll expenditure;
- receipt and review of evidence for our testing of Council Tax reliefs;
- receipt and review of breakdown of petty cash;
- completion of review of accounting for Private Finance Initiative (PFI liabilities);
- completion of review of accounting treatment for LOBO loans;
- completion of review of significant judgements and assumptions made in respect of property, plant and equipment land and building valuations;
- details of income and expenditure and assets and liabilities in 2017/18 for group interests of the Council that have not been consolidated into the group financial statements;
- completion of review of the accounting for the transfer of properties to Croydon Affordable Homes LLP, including receipt of the legal advice obtained by the Council;
- receipt of management representation letter;
- final senior management quality review processes;
- review of the final set of financial statements; and
- review of the Whole of Government Accounts consolidation pack.

Summary (continued)

Our approach to materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law.

Our assessment of the value of materiality, performance materiality and trivial matters has been adjusted from the amounts communicated in our Audit Plan dated 15 March 2018 because we have recalculated them based upon the outturn position reported in the draft 2017/18 financial statements. We detail in the table below our assessment of materiality for the London Borough of Croydon.

	Group Amount (£)	Council Amount (£)	Qualitative factors considered
Materiality for the financial statements	£23,483,000	£23,481,000	• In calculating materiality, we have considered the users the financial statements and the extent to which they place reliance on the financial statements.
Performance materiality	£17,612,000	£17,611,000	• In calculating performance materiality, we have considered the Council's control environment and the likelihood of material misstatements of the financial statements arising.
Trivial matters	£1,000,000	£1,000,000	• We have considered the level at which audit misstatements would be of interest to members of the General Purposes and Audit Committee in discharging their duties.
Materiality for specific transactions, balances or disclosures	• Disclosures of senior officer salaries - £10,000 • Related party transactions - £4,000,000	• Disclosures of senior officer salaries - £10,000 • Related party transactions - £4,000,000	• We have identified these as disclosures where misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users.

Going concern

Our responsibility

As auditors, we are required to "obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern" (ISA (UK) 570).

Going concern material uncertainty disclosures

The Authority's financial statements have been prepared on a going concern basis; that is, the accounts have been prepared on the assumption that the functions of the Authority will continue in operational existence for the foreseeable future. Transfers of services under machinery of Government changes, such as Local Government reorganisation, do not negate the presumption of going concern.

Going concern commentary

Management's assessment process	Auditor commentary
Management have prepared a medium term financial strategy covering up to 2020/2021, which indicates that the Council will continue to deliver a balanced budget over that period.	• We are satisfied regarding the appropriateness of management's process for formulating their going concern assessment.
Work performed	**Auditor commentary**
Detail audit work performed on mgmts. assessment	• We have reviewed the medium term financial strategy and considered the reasonableness of the assumptions on which it is based. • We note that your reserves have fallen significantly over the last two years, with total general fund and earmarked reserves standing at £28.5 million as at 31 March 2018, compared to £50.8 million as at 31 March 2016 and £40.8 million as at 31 March 2017. While your reserves have capacity to fund some overspends, they would not be sufficient in the event of significant recurrent overspends over the medium term. • Despite the risks posed by the low level of your reserves, it is clear that you remain a going concern for the period to 31 July 2019, the period covered by our review of your going concern assessment.
Concluding comments	**Auditor commentary**
	• We have identified no events or conditions in the course of the audit that we consider may cast significant doubt on your ability to continue as a going concern. • We are satisfied with the appropriateness of management's going concern assessment process. As such we plan to issue an unmodified audit report in respect of going concern.

Significant audit risks

	Risks identified in our Audit Plan	Commentary
1	**Improper revenue recognition** Under ISA 240 (UK) 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.	**Auditor commentary** 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, mean that all forms of fraud are seen as unacceptable Therefore we do not consider this to be a significant risk for the London Borough of Croydon.
2	**Management override of controls** Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. You face external scrutiny of its spending, and this could potentially place management under undue pressure in terms of how they report performance. We identified management override of controls as a risk requiring special audit consideration.	**Auditor commentary** • We undertook the following procedures in relation to this risk: – gained an understanding of the significant accounting estimates, judgements applied and decisions made by management and consider their reasonableness; – obtained a full listing of journal entries, identified and then tested unusual journal entries for appropriateness; and – evaluated the rationale for any changes in accounting policies or significant unusual transactions that came to out attention during the course of the audit. • Our work has not identified any issues in respect of this risk.

Significant audit risks

	Risks identified in our Audit Plan	Commentary
3	**Valuation of property, plant and equipment** You re-value your Council dwellings annually and its other classes of land and buildings on a quinquennial basis to ensure that their carrying value is not materially different from fair value. This the includes the valuation of council dwellings, other land and buildings and surplus assets not held for sale components of your property, plant and equipment. This represents a substantial estimate by management in the core financial statements and group accounts, due to the size of the valuation and the sensitivity of the valuation to changes in the changes in significant judgments. We therefore identified the valuation of land and buildings as a significant risk, which was one of the most major assessed risks of material misstatement. and a key audit matter for the audit.	**Auditor commentary** • We undertook the following procedures in relation to this risk: – reviewed management's processes and assumptions for the calculation of the estimate; – reviewed the competence, expertise and objectivity of the valuation specialists used; – reviewed the instructions issued to valuation experts and the scope of their work; – considered the completeness and accuracy of the information supplied by you to the valuation experts; – discussed with the Council's valuer the basis on which the valuation was carried out, challenging the key assumptions; – reviewed and challenged the information used by the valuer to ensure it was robust and consistent with our understanding; – tested revaluations made during the year to ensure they were input correctly into the your fixed assets register; and – evaluated the assumptions made by management for those assets not revalued during the year and how management satisfied themselves that these were not materially different to current value. • Our audit work in relation to this risk remains in progress. We will provide and update to you at the General Purposes and Audit Committee meeting of our conclusion in respect of this risk.
4	**Valuation of pension fund net liability** The Authority annually engages an actuary to value its net pension fund liability in respect of the Local Government Pension Scheme. Due to its size and sensitivity to changes in key assumptions, this represents a substantial estimate by management in the Council's financial statements and the group accounts. We identified the valuation of the pension fund net liability as a risk requiring special audit consideration and a key audit matter for the audit.	**Auditor commentary** • We undertook the following procedures in relation to this risk: – gained an understanding of the processes and controls put in place by management to ensure that the net pension fund liability was not materially misstated and evaluating the design of the associated controls; – reviewed the competence, expertise and objectivity of the actuary who carried out your 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; and – reviewed the consistency of the pension fund net liability disclosures in notes to the financial statements with the actuarial report from your actuary. • Our audit work has not identified any issues in respect of this risk.

Reasonably possible audit risks

	Risks identified in our Audit Plan	Commentary
7	**Employee remuneration** Payroll expenditure represents a significant percentage (26%) of the Council's gross revenue expenditure. As the payroll expenditure comes from a number of individual transactions and an interface with a number of different sub-systems there is a risk that payroll expenditure in the accounts could be understated. We therefore identified completeness of payroll expenses as a risk requiring particular audit attention	**Auditor commentary** • We undertook the following procedures in relation to this risk: – 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; – evaluated the Council's accounting policy for recognition of payroll expenditure for appropriateness; – tested payroll expenditure for your main payroll for the year using a substantive analytical review; – substantively tested a sample of payroll payments to schools employees paid through external payrolls. • Our audit work has not identified any issues in respect of this risk.
8	**Operating expenses** Non-pay expenses on other goods and services also represents a significant percentage (58%) of the Council's gross revenue expenditure. Management uses judgement to estimate accruals of un-invoiced costs. We identified completeness of non- pay expenses as a risk requiring particular audit attention:	**Auditor commentary** • We undertook the following procedures in relation to this risk: – evaluated the Council's accounting policy for recognition of non-pay expenditure for appropriateness; – gained an understanding of your system for accounting for non-pay expenditure and evaluate the design of the associated controls; and – tested a sample of post-year end payments to test the completeness of expenditure recorded in the financial statements. • From our testing of your year end creditors balance, we identified a £3,000 creditor balance included in your creditors listing on your Accounts Payable system that should have been written out because there were no invoices outstanding with this supplier as at the year end. We also identified a £1,135 s.106 receipts in advance balance that management were not able to provide us with supporting evidence for due to this balance having not been properly referenced when it was first recorded. We have evaluated both of these errors and concluded that neither of these matters are indicative of a wider material misstatement in your year end reported creditors position. • Our audit work has not identified any other issues in respect of this risk.

Reasonably possible audit risks – new risks identified

This section provides commentary on new reasonably possible risks which were identified during the course of the audit that were not previously communicated in the Audit Plan.

	Risks identified	Commentary
9	**Setup of Croydon Affordable Homes LLP** During the year, you set up Croydon Affordable Homes LLP (CAH LLP), a new not-for-profit body that manages a portfolio of affordable accommodation for homeless families. CAH LLP entered into a number of leases with the Council to acquire 96 non-HRA properties under an 80 year lease. This was funded through a combination of a loan from the Council and Housing Revenue Account Right To Buy capital receipts and enabled you to recognise a £21.9 million flexible capital receipt.	**Auditor commentary** • We undertook the following procedures in relation to this risk: – gained an understanding of the transactions entered into with CAH LLP and of your arrangements for management oversight over those transactions; – reviewed the accounting treatment and significant accounting judgements made in respect of the transactions with CAH LLP; – reviewed governance arrangements for CAH LLP and its parent, Croydon Affordable Housing Ltd, to consider whether they fall under the control of the Council; – reviewed governance arrangements and transactions for the two entities set up to hold the Council's equity interest in CAH LLP, London Borough of Croydon Holdings LLP and Croydon Holdings Ltd, to consider whether they should be consolidated within your group accounts; and – review of the legality of the use of HRA Right To Buy capital receipts to fund a portion of this transaction. • Our review of the accounting treatment applied for these transactions remains in progress and we await receipt of the legal advice received by the Council. • You recognised in your draft accounts a provision of £2,000k premium that you received in respect of a financing transaction between CAH LLP and a third party, Canada Life. We have noted that this does not satisfy the requirements to account for as a provision and you have decided to recognise this as income instead. • We have noted that no disclosure was provided in the accounts of the judgement made by management that the leases entered into with Croydon Affordable Homes LLP have resulted in the transfer of control of the properties, even though you retain some of the benefits from their future operation including a share of the net income from rental of the properties and rights of nomination of tenants. • Our audit work in relation to this risk remains in progress. We will provide and update to you at the General Purposes and Audit Committee meeting of our conclusion in respect of this risk.

Significant findings arising from the group audit

Component	Component auditor	Findings	Group audit impact
Brick By Brick Croydon Limited	Grant Thornton (UK) LLP	• The statutory audit of Brick By Brick Croydon Limited for the year ended 31 December 2017 was completed on 3 May 2018. • An unqualified conclusion was issued in respect of Brick By Brick Croydon Limited's financial statements. • The audit was undertaken by Grant Thornton (UK) LLP and the group audit team has had full access to the component auditor's work papers.	• No audit findings material to the group financial statements were noted during the audit Brick By Brick Croydon Limited. • Management have opted to restate the group financial statements in respect of an immaterial prior period adjustment identified during the audit of Brick By Brick Croydon Limited.

Accounting policies

Accounting area	Summary of policy	Comments	Assessment
Revenue recognition	• You have four principal revenue streams: – taxation revenues in respect of council tax and business rates are recognised in the year that the tax was levied; – grant income is recognised in accordance with the terms of the grant, whether specific or non-specific – income from social housing dwelling rents is recognised evenly over the period to which it relates; and – income from fees and charges in the provision of services is recognised when the service has been provided or when the title to goods has passed.	• We have no concerns with your revenue recognition policies or with the application of those policies. The revenue recognition policies adopted are in line with the CIPFA Code of Practice.	● Green

Assessment

- ● Marginal accounting policy which could potentially be open to challenge by regulators
- ● Accounting policy appropriate but scope for improved disclosure
- ● Accounting policy appropriate and disclosures sufficient

Accounting policies (continued)

Accounting area	Summary of policy	Comments	Assessment
Valuation methods	• Council dwellings are valued at their current value, determined using the basis of existing use value for social housing. • Other land and buildings are valued at their current value, determined as the amount that would be paid for the asset in its existing use, or at the depreciated replacement cost, depending upon the nature of the asset. • Surplus assets and investment property are valued at fair value, estimated at the highest and best use from a market participant's perspective with respect to property market valuation data. • The actuarial valuation of the net pension liability was determined based upon an assessment of the future payments that will be made in relation to retirement benefits, discounted to their value at current prices and netted off against the fair value of pension assets based upon their market value at the year end. • The fair value of financial assets disclosed in note 16 is determined based upon market data of conditions as at 31 March 2018. • The fair value of financial liabilities disclosed in note 16 has been determined on a new loans basis, based upon the net present value of a liability on equivalent terms entered on the prevailing market borrowing rate as at 31 March 2018.	• We have not identified any issues in relation to any of the valuation methods used to calculate significant valuations in the financial statements. • Our audit work in relation to review of your asset revaluations remains in progress. We will provide and update to you at the General Purposes and Audit Committee meeting of our conclusion in respect of this risk. • We are not aware of any significant changes in valuation methods used compared to previous years.	● Green

Assessment
- ● Marginal accounting policy which could potentially be open to challenge by regulators
- ● Accounting policy appropriate but scope for improved disclosure
- ● Accounting policy appropriate and disclosures sufficient

Accounting policies (continued)

Accounting area	Summary of policy	Comments	Assessment
Other judgements and estimates	• Other key estimates and judgements include: – Useful life of Property, Plant and Equipment – Impairments – Doubtful debt provision – Expenditure accruals – NNDR appears provision – Private Finance Initiative (PFI) liability – Judgements around recognition of schools land and buildings on the Balance Sheet – Judgements around which entities to consolidate within the Group financial statements	• We have not identified any issues in relation to any of the other significant judgements and estimates reflected in the financial statements.	Green
Consolidation of Brick By Brick Croydon Limited	• You have consolidated the financial position and financial performance of Brick By Brick Croydon Limited into your financial statements on the basis of the outturn position reported the company's audited statutory accounts for the year ended 31 December 2017. • This is a change in approach from the prior year, when you included expenditure of Brick By Brick Croydon for January – March within the group financial statements. • You have restated the 2016/17 comparative group accounts to reflect the new basis of preparation adopted in 2017/18.	• We are satisfied that the general basis of consolidation adopted is materially reasonable. • We have identified a number of adjustments to errors in the consolidation process, which are set out in Appendix C. • We note that it was not necessary for management to restate the group financial statements because the restatement posted by management was immaterial.	Amber
Other critical policies	• You have adopted accounting policies that are consistent with the CIPFA Code of Practice.	We have reviewed your policies against the requirements of the CIPFA Code of Practice. Your accounting policies are appropriate and consistent with previous years.	Green

Assessment
- Marginal accounting policy which could potentially be open to challenge by regulators
- Accounting policy appropriate but scope for improved disclosure
- Accounting policy appropriate and disclosures sufficient

Other communication requirements

We set out below details of other matters which we, as auditors, are required by auditing standards and the Code to communicate to those charged with governance.

	Issue	Commentary
1	**Matters in relation to fraud**	• We have previously discussed the risk of fraud with the General Purposes and Audit Committee in our Audit Plan dated 15 March 2018. We have not been made aware of any other incidents in the period and no other issues have been identified during the course of our audit procedures.
2	**Matters in relation to related parties**	• We are not aware of any related parties or related party transactions which have not been disclosed.
3	**Matters in relation to laws and regulations**	• You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any incidences from our audit work.
4	**Written representations**	• A standard letter of representation has been requested from you, including specific representations in respect of the group, which is included in the General Purposes and Audit Committee papers.
5	**Confirmation requests from third parties**	• We requested from management permission to send confirmation requests in respect of your cash, borrowings and investment balances as at 31 March 2018. This permission was granted and the requests were sent. All of these requests were returned with positive confirmation.
6	**Disclosures**	• Our review identified a number of errors and omissions in the discloses provided within the financial statements. These are detailed in Appendix C.
7	**Audit evidence and explanations**	• All information and explanations requested from management was provided.
8	**Significant difficulties**	• We experienced no significant difficulties in performing the audit.

Other responsibilities under the Code

We set out below details of other matters which we, as auditors, are required by the Code to communicate to those charged with governance.

	Issue	Commentary
1	**Other information**	• We are required to give an opinion on whether the other information published together with the audited financial statements (including the Statement of Accounts, Annual Governance Statement (AGS) and Narrative Report), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. • No inconsistencies have been identified/Inconsistencies have been identified but have been adequately rectified by management. We plan to issue an unqualified opinion in this respect – refer to draft audit report in the General Purposes and Audit Committee papers accompanying this report.
2	**Matters on which we report by exception**	We are required to report on a number of matters by exception in a numbers of areas: • If the Annual Governance Statement does not meet the disclosure requirements set out in the CIPFA/SOLACE guidance or is misleading or inconsistent with the other information of which we are aware from our audit. • If we have applied any of our statutory powers or duties. We have nothing to report on these matters.
3	**Specified procedures for Whole of Government Accounts**	We are required to carry out specified procedures (on behalf of the NAO) on the Whole of Government Accounts (WGA) consolidation pack under WGA group audit instructions. As the Council exceeds the specified group reporting threshold of £500m we examine and report on the consistency of the WGA consolidation pack with the Council's audited financial statements. This work is not yet completed and we plan to undertake the WGA review in August 2018, after the conclusion of the audit.
4	**Certification of the closure of the audit**	We do not expect to be able to certify the completion of the 2017/18 audit of the London Borough of Croydon in our auditor's report, as detailed in the draft audit opinion accompanying this report as we have not yet completed our review of your WGA consolidation pack.

Value for Money

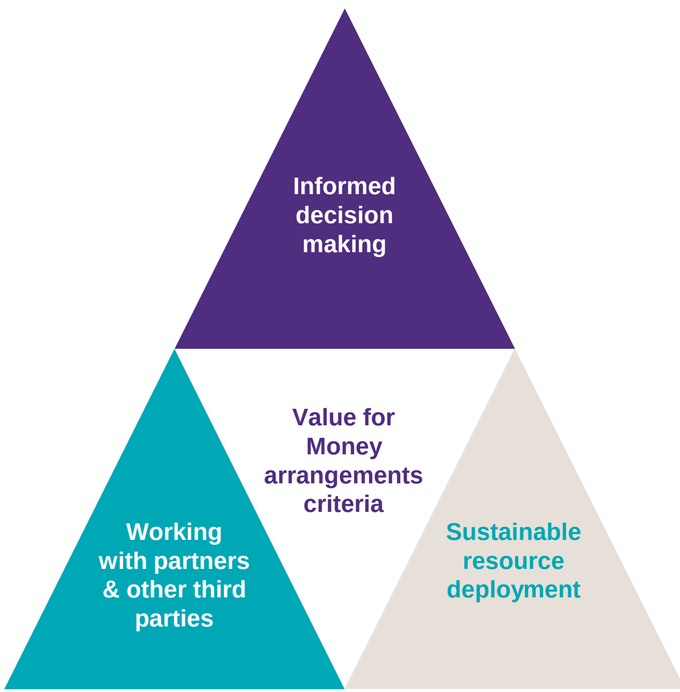
Background to our VFM approach

The NAO issued its guidance for auditors on Value for Money work for 2017/18 in November 2017. The guidance states that for local government bodies, auditors are required to give a conclusion on whether you have proper arrangements in place.

The guidance identifies one single 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."

This is supported by three sub-criteria, as set out below:



Risk assessment

We carried out an initial risk assessment in March 2018 and identified a number of significant risks in respect of specific areas of proper arrangements using the guidance contained in AGN03. We communicated these risks to you in our Audit Plan dated 15 March 2018.

We have continued our review of relevant documents up to the date of giving our report, and have not identified any further significant risks where we need to perform further work.

We carried out further work only in respect of the significant risks we identified from our initial and ongoing risk assessment. Where our consideration of the significant risks determined that arrangements were not operating effectively, we have used the examples of proper arrangements from AGN 03 to explain the gaps in proper arrangements that we have reported in our VFM conclusion.

Value for Money

Our work

AGN 03 requires us to disclose our views on significant qualitative aspects of your arrangements for delivering economy, efficiency and effectiveness.

We have focused our work on the significant risks that we identified in the Council's arrangements. In arriving at our conclusion, our main considerations were:

- As at 31 March 2018, you had total general fund reserves and earmarked reserves excluding schools reserves of £26.1 million, compared to £40.8 million as at 31 March 2017 and £50.8 million as at 31 March 2016. This represents 9.8% of your budget requirement for 2018/19 which is low relative to other London Boroughs and to the levels of reserves that you have historically held. This highlights the importance of taking firm action to ensure that spending is contained within the budget going forward.
- During 2017/18, you commenced the operation of the “One Croydon” Outcomes Based Commissioning Alliance Agreement with NHS Croydon CCG to develop an Integrated Health and Social Care system for the over 65s population in Croydon.
- In September 2017, Ofsted issued a report on the inspection of your services for children in need of help and protection that you are “inadequate”.
- We consider that the outcome of the Ofsted inspection of your children's’ services is evidence of weaknesses in proper arrangements for understanding and using appropriate and reliable financial and performance information to support informed decision making and performance management, and for planning, organising and developing the workforce effectively to deliver strategic priorities.
- In all respects other than the issues noted by Ofsted in relation to your children's’ services, we have concluded from our work completed we have no matters to report around your arrangements for securing economy, efficiency and effectiveness in your use of resources

We have set out more detail on the risks we identified, the results of the work we performed and the conclusions we drew from this work on pages 19 to 26.

Recommendations for improvement

We discussed findings arising from our work with management and have agreed recommendation for improvement which are as follows:

- you should ensure that you continue to take action to prevent overspends from arising for the People department;
- you should identify alternative means for funding transformation expenditure in the longer term once flexible capital receipts are no longer available to fund this expenditure; and
- you should ensure that a clear strategy is in place for maintaining your reserves at a sustainable level.

Our recommendations and management's response to these can be found in the Action Plan at Appendix A

Overall conclusion

Based on the work we performed to address the significant risks, we concluded that:

- except for the matter we identified in respect of the Ofsted inspection of children's’ services, you had proper arrangements in all significant respects. We therefore propose to give a qualified 'except for' conclusion on your arrangements for securing economy, efficiency and effectiveness in your use of resources.

The text of our proposed report can be found in the paper accompanying this report.

Significant difficulties in undertaking our work

We did not identify any significant difficulties in undertaking our work on your arrangements which we wish to draw to your attention.

Significant matters discussed with management

There were no matters where no other evidence was available or matters of such significance to our conclusion or that we required written representation from management or those charged with governance.

Key findings

We set out below our key findings against the significant risks we identified through our initial risk assessment:

	Significant risk	Findings
1	**Ofsted inspection of children's services** Ofsted issues a report on your children's services in September 2017 that gave a rating of 'inadequate' and you are currently subject to follow up review by Ofsted. In response to this you have implemented an Improvement Plan to address the concerns that Ofsted raised. We have reviewed progress made in implementing the changes to your arrangements requested by Ofsted. We have also considered your performance against your internal objectives and targets in delivering a safe and reliable children's service.	On 4 September 2017, Ofsted published a report on their findings from inspection of your services for children in need of help and protection, children looked after and care leavers and review of the effectiveness of the Local Safeguarding Children Board that rated you as "inadequate". The key findings of the report are as follows: - there had been a significant deterioration in the quality of service provision in relation to children's services since the previous inspection in 2012; - management oversight of social care practice was weak; - the workloads of social workers in some teams were high; - there was been a lack of challenge from the Local Safeguarding Children Board; and - the failings identified left some children at risk of severe harm including risk of sexual exploitation. Your members and senior officers have accepted all the shortfalls found by Ofsted and following the inspection developed an immediate action plan in response to their findings. An Improvement Plan has been developed that sets out how you will improve your children's services and a Children's Improvement Board, chaired by an independent chair, has been setup to provide oversight of the change required. A Children's Services Improvement Team chaired by the Chief Executive has also been established to ensure that the actions within the Improvement Plan are operationalised and are making the necessary impact, and advise the Improvement Board on the overall implementation of the Improvement Plan. Following the inspection, the Department for Education issued a statutory direction under section 497A (4B) of the Education Act 1996 to appoint a commissioner to undertake a review of your capacity and capability to improve your children's services and to recommend whether control of these services remain with the Council. The commissioner subsequently reported in January 2018 that the control of children's social care in Croydon should be left under the control of the Council. The report noted that you had taken action to setup appropriate arrangements to deliver the improvements to children's services required but noted that "it is very early days and the scale of the challenge is just beginning to be understood".

Key findings (continued)

	Significant risk	Findings
1	**Ofsted inspection of children's services** Continuation of risk noted on page 19.	A revised direction was published by the Department for Education in January 2018 that required you to agree arrangements for intensive peer support with the London Borough of Camden. Camden received a rating of "good" in the most recent rating of their children's services by Ofsted and the sharing of their expertise will be useful in supporting Croydon's improvement journey. The peer support proposals were submitted to the Minister of State for Vulnerable Children and Families in April 2018 and approved. A revised statutory direction was then published by the Secretary of State in May 2018 requiring you to co-operate with Camden Council on the proposals and setting out the arrangements for monitoring and reporting progress against these Ofsted undertook a follow-up monitoring visit in March 2018 and noted that "senior leaders and managers in Croydon are progressing well in implementing their improvement plan and they have quickly responded to issues identified in the first monitoring visit. The local authority has invested a significant amount of additional resources to improve the quality of children's services." However, they also found that "the quality of practice for vulnerable adolescents continues to be highly variable and, in some cases, remains inadequate." **Conclusion** It is clear from the findings of Ofsted that there are deficiencies in the quality of your children's services. You have acknowledged this and are working hard to address their findings. Your initial progress, as noted by Ofsted in their monitoring visit in March 2018, has been promising. It is clear that you now have appropriate plans and governance structures in place to support the changes required. However, significant progress is still required in order to rectify all of the concerns that Ofsted have noted. You believe that addressing the concerns of Ofsted will take two to three years, and you are only still in the early stages of this improvement journey. **On the basis of the work completed we have concluded that you do not have adequate arrangements for achieving economy, efficiency and effectiveness in relation to your children's services functions.**

Significant risk	Findings
2 **Budget position and medium term financial planning** In light of the increasing funding pressures that you face, there is a risk that you will not be able to generate new revenue streams or deliver saving cuts of sufficient scale to maintain a balanced budget over the medium term. We have reviewed recent performance against the budget and considered the reasonableness of the significant assumptions upon which your medium term financial planning has been based.	**Revenue outturn position for 2017/18** In common with the majority of other local authorities in London and nationally, you have faced significant financial challenges in recent years as a result of reductions in government funding at a time of increases in demand for services, particularly around children's services and social care. You provide services to a large and varied demographic, including many individuals with complex needs, and this has made your capacity to weather these funding reductions all the more stretched. In 2017/18 this pressure has continued and you have also faced additional challenges as a result of additional investment in your children's services in response to your Ofsted inspection and costs incurred in supporting unaccompanied asylum seeking children and as a result of national policies on welfare reform. As a result of these pressures you have reported an outturn position for 2017/18 of a deficit of £5.0 million. This reflects an overall overspend of £6.8 million at a department level and £6.3 million of exceptional items, offset by an underspend of £8.0 million at a corporate level. The exceptional items reported relate to expenditure incurred that you consider should be funded by the government, including costs associated with the introduction of universal credit and costs related to unaccompanied asylum seeking children. The overspend at a departmental level was primarily due to an overspend of £8.8 million for the People department, which arose due to increases in the number of external placements and specialist foster care placements for looked after children and an increase in the cost of section 17 B&B places for customers of the care planning service. When the exceptional items are considered as well, the total overspend for the People department was £15.6 million. Due to the nature of the services that the People department provides, which face a high level of external scrutiny around quality of care and increasing demand, it is harder to prevent overspends in this area of your service than for your other departments. Though there have been significant efforts by management to control costs in this area, the People department has been a persistent area where overspends have occurred, reporting overspends of £10.0 million in 2016/17, £9.7 million in 2015/16 and £7.8 million in 2014/15. You have plans in place for managing expenditure in the People department going forward including an additional investment of £10 million in your 2018/19 budget and recent progress made in greater integration between health and social care through the One Croydon Alliance are showing promising results. However, it remains critical to your financial health that you continue to take action to control costs in this area. Recommendation: **You should ensure that you continue to take action to prevent overspends from arising for the People department.** During the year you utilised £14.5 million of flexible capital receipts to fund transformation expend, as is permitted by a statutory direction published by the Ministry of Housing, Communities & Local Government in March 2016. You plan to use a further £6.0 million of such funding in 2018/19 to fund further transformation. This has allowed you to fund a variety of schemes that you expect to reduce future demand and to generate revenue savings in the longer term. This has also allowed you to fund additional costs incurred as a result of the need to respond to the findings of Ofsted on your children's services. This expenditure has been funded primarily from capital receipts received from the transfer of properties to Croydon Affordable Homes LLP.

	Significant risk	Findings
2	**Budget position and medium term financial planning** Continuation of risk noted on page 21.	Though the majority of this expenditure was used to fund transformation projects that would not have been undertaken had funding not been available, or to fund costs associated with transformation of children's services that were not previously foreseen, some element of these receipts were used transformation expenditure that was originally forecast within the 2017/18 budget to be funded from the revenue budget. Had these capital receipts not been available, then these expenditure elements would have been born by the general fund and the deficit for the year increased. Due to the non-recurrent nature of capital receipts, over the longer term it will be necessary to fund transformation expenditure from the revenue budget once and you should consider options for how this will be financed. Recommendation: **You should identify alternative means for funding transformation expenditure in the longer term once flexible capital receipts are no longer available to fund this expenditure.** **Capital outturn position for 2017/18** During the year, you have delivered a variety of significant capital schemes including, but not limited to, the commencement of the New Addington Leisure Centre, the restoration of Old Ashburton Library and the refurbishment of Fairfield Halls. You have also continued construction of new housing through your wholly-owned development company Brick By Brick Croydon Ltd, which you expect to both improve housing provision within Croydon and generate you a good return on your investment. Your capital outturn spend for 2017/18 was £140 million, compared to your revised capital programme for the year of £222 million. This represents an underspend of 32% against the budget, which is attributable mainly to slippage in the delivery of schemes. This compares to an underspend against the capital budget of 45% in 2016/17 and 27% in 2015/16. For the Housing Revenue Account capital programme, total expenditure was £26 million compared to a budget of £31 million, giving a total underspend of 16%. This included urgent fire safety works following the Grenfell fire. Overall, while there was some slippage against the capital budget for 2017/18, this was at a reduced level compared to the previous year and we have noted no value for money concerns in respect of your outturn capital performance.

Significant risk	Findings
2 **Budget position and medium term financial planning** Continuation of risk noted on page 21.	**Reserves and financial position**

As a result of the financial pressures that you have faced, your reserves have reduced significantly over the recent years. As at 31 March 2018, you had total general fund reserves and earmarked reserves excluding schools reserves of £26.1 million, compared to £40.8 million as at 31 March 2017 and £50.8 million as at 31 March 2016. This represents 9.8% of your budget requirement for 2018/19 which is low relative to other London Boroughs and to the levels of reserves that you have historically held. This highlights the importance of taking firm action to ensure that spending is contained within the budget going forward.

The following table sets out a summary of your reserves position and key financial ratios as at 31 March 2018 relative to other London Boroughs as per their draft published financial statements for 2017/18:

London Borough of Croydon - financial position: key performance measures

Measure	London Borough of Croydon	Average for London Boroughs	Ranking relative to other London Boroughs
Total general fund and non-schools earmarked general fund reserves as at 31 March 2018 (£m)	26,139	102,647	32 / 32
Total general fund and earmarked general fund reserves as at 31 March 2018 (£m)	28,546	112,924	32 / 32
Total usable revenue and capital reserves as at 31 March 2018 (£m)	114,739	253,592	26 / 32
Useable capital and revenue reserves as a percentage of gross service revenue expenditure	9.8%	28.9%	32 / 32
Current ratio (current assets / current liabilities)	0.72	1.50	28 / 32

This analysis highlights that as at 31 March 2018, you had the lowest total general fund and earmarked reserves of all 32 London Boroughs and that relative to your peers you were in a below average financial standing. While direct comparison between different Councils can be misleading due to differences in funding from central government and the needs of the demographic served as well as other local factors, this nevertheless highlights an area which you need to continue to address.

We note that the majority of reserves were used for the reasons they were earmarked for example Street Lighting PFI reserve, were reserves to reduce in 2018/19 to a similar extent to the reductions in reserves that arose during 2016/17 and 2017/18, you would be very close to breaching your statutory duty to deliver a balanced budget. You have budgeted for a £4.7 million increase in reserves in 2018/19, which is funded from the council tax collection fund surplus as at the end of 2017/18, and a further £4.7 million increase in reserves has been forecast 2019/20. If achieved, this will boost your reserves position further and provided you with greater capacity to respond to future demand pressures. You have a number of actions in place to increase your income in future years which your forecasts indicate will cover growth in demand. This will go some way to strengthening your reserves position, though this would still leave your reserves at a low level and you would continue to be subject to risk around your continued financial resilience.

Recommendation: You should ensure that a clear strategy is in place for maintaining your reserves at a sustainable level.

Significant risk	Findings
2 **Budget position and medium term financial planning** Continuation of risk noted on page 21.	**<u>2018/19 budget and medium term financial planning</u>** In February 2018, you approved a two year budget covering 2018/19 and 2019/20 which indicates that you will continue to deliver a balanced budget in both periods. While attainment of your savings targets will be challenging, the majority of these savings have been identified and these targets are not unreasonable compared to the historical trend of savings that you have achieved in recent years. You have appropriate infrastructure and frameworks in place to support the delivery of planned savings, including monthly monitoring for high risk areas, and the challenge you face is in ensuring that each of your departments take ownership for supporting the delivery of your savings plans. Your current medium term financial plan (MTFP) only covers the period up to 31 March 2020 and you are in the process of agreeing your next four year MTFP with final agreement planned for Autumn 2018. We note your plans to base your MTFP on assumptions that are consistent with the Local Government Association guidance and to grow your income base. As your continue to experience increased development within your borough, you are expecting growth in your Council Tax base, increased revenue from your growth zone, increased fees and charges and increased revenue from Brick by Brick Croydon Ltd. You are also looking at other developments that may increase future revenue streams. You have made use of the flexible capital receipts to fund transformation expenditure in 2017/18 and you are expecting a further £30 million of capital receipts which will be available to you to use flexibly within the directions of the scheme. Given your current low level of your reserves, understanding your future savings requirement and your assumptions for income growth are of particular significance to maintaining your financial standing going forward. You have a number of actions in place that aim to address the risk associated with a low level of reserves and it is important that the progress and impact of those actions continue to be monitored closely. **<u>Conclusion</u>** Your reserves are now at a very low position and you face a number of clear risks to your continued financial health. You have plans in place to take appropriate action to manage cost pressures, increase income sources and address the level of your reserves. The progress and impact of your actions are vital to enable you to deliver a balanced budget over the medium term. **On the basis that you delivered a balanced budget in 2017/18 and can reasonably expect to do so in 2018/19, we have concluded that the risk that we identified in respect of your budget position has been sufficiently mitigated and that you have proper arrangements.**

Significant risk	Findings
3 **Health and social care integration** You are seeking to deliver wide ranging changes and greater integration to ensure financial sustainability of adult health and social care services. This project is complex and high profile, but there are significant benefits to improved service delivery and financial savings. We have reviewed your progress to date in implementing the planned integration and considered its arrangements for monitoring and managing risks and to ensure that benefits from integration are realised.	Health and social care services both in Croydon and nationwide face enormous pressure. There are a number of initiatives to bring together services in new ways and deliver genuine and effective collaboration between the NHS, local authorities and other providers. The challenge faced by Croydon is particularly acute. The local hospital trust, Croydon Health Services NHS Trust (CHS), is in severe financial difficulties and your local CCG is also in deficit. Provision of social care services is an area where you face significant financial pressure, due to rising demand at a time of reduced funding. Closer integration with the NHS creates opportunities for improved management of demand and therefore reductions in the budget pressures that you face, while also providing better outcomes for patients through more joined-up working. Health and social care integration therefore reflects a key area of transformation that will be crucial to your longer term financial stability. We have considered below some of the key initiatives you are participating in to deliver an integrated service. **<u>Outcomes Based Commissioning</u>** During 2016/17 you commissioned, jointly with NHS Croydon CCG, a 10 year contract to develop an Integrated Health and Social Care system for the over 65s population in Croydon. This arrangement commenced from 1 April 2017 and involves an overall budget of around £180 million per annum, of which £42 million is funded from yourselves. The "One Croydon" Outcomes Based Commissioning (OBC) Alliance Agreement awards service contracts to a variety of providers and you act as both a commissioner and provider of services. This arrangement does not constitute a separate entity, but is instead a strategic alliance between the Council and CCG for delivery of joined up priorities. The aim is for all partners to come together and provide high quality, safe, seamless and personalised care to older people in Croydon to help them stay independent. The service is commissioned based on outcomes that you are looking to see delivered, and these are a key measure in determining the contract pricing and structure. Croydon as an area faces particular challenges, including a growing and ageing population, and the financial challenges already mentioned. The model is planned to deliver substantial savings and ensure services are commissioned effectively within available resources. The implementation of the Alliance Agreement has progressed well, with no significant unforeseen challenges arising to date. This is a positive reflection of the planning and monitoring structures put in place to support this transition. As a reflection of your confidence in the new arrangements during 2017/18, you agreed to an extension of the Alliance Agreement beyond just over 65s to allow potential for a whole system transformation for health and social care. This is an ambitious goal, but if achieved successfully will allow you to improve both the quality of the care that you provide and improved financial resilience around social café services. The OBC model is new and remains in an early stage. It will take some time to see the true impact of the changes, but the plans do demonstrate the work you are doing to deliver services differently and work in partnership with other providers. Success factors will be not only the achievement of challenging financial targets, but delivering a truly integrated and effective service, however, there are clear risks to the position that have been appropriately identified and must be robustly monitored.

Significant risk	Findings
3 **Health and social care integration** Continuation of risk noted on page 25.	**Sustainability and Transformation Plans (STP)** You are part of the South West London STP. This aims to bring together the various organisations and ensure the delivery of quality services, address future health challenges and deliver within the limited resources available. The original STP plan was submitted on 21 October 2016 and reflects the challenges you face and proposes a number of solutions to deal with these at both the South West London level and the Croydon level. Failures within one part of the system can easily have a knock on implication for another part, so it is critical that all work together effectively to deliver for the areas. During 2017/18, the STP plans have continued to develop. In July 2017, NHS England rated the South West London STP as "making progress" from their review of STP arrangements nationally, highlighting that the arrangements continued to be early stages and in need of further development. A refreshed STP was published in November 2017 that reflects feedback received from stakeholders during the year and has been developed to strengthen the focus on partnership, prevention and keeping people well, and to reflect that the greatest influences on health and well-being are factors such as education, employment, housing, healthy habits and social connections. The plans have moved into the implementation stage. While you have not formally committed to any financial plans as part of the control total for the STP, your involvement in the One Croydon Alliance Agreement is aligned with the priorities of the STP and forms a core pillar of the new operating structure for provision of healthcare in Croydon. There have been a number of reports to the Health and Wellbeing Board and the Health and Social Care Scrutiny Sub-Committee detailing the work to date and the plans in place. The overall governance arrangements appear sound. It is not clear at this stage how effective they will be at delivering genuine joined up care. The STP requires much closer working between the NHS and local authorities, and you have arrangements in place to pursue this. The continued provision of effective social care is critical to preventing people from needing hospital stays and reducing delayed transfers of care. Balancing the financial challenge with ongoing increases in demand is a recognised national issue, and additional funding is being earmarked. However, it will be critical to ensure funds are appropriately targeted, and that both yourselves and the NHS consider the holistic picture when making financial and non-financial decisions over service provision. This is challenging, particularly in light of NHS England's increasing focus on short term, year end deficit positions. **Conclusion** **On the basis of the work completed we have concluded that the risk was sufficiently mitigated and that you have proper arrangements.**

Independence and ethics

Independence and ethics

- We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. The firm, its partners, senior managers, managers and network firms have complied with the Financial Reporting Council's Ethical Standards and confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in December 2017 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

Details of fees charged are detailed in Appendix D.

Independence and ethics

Non-audit services

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The following non-audit services were identified:

Service	£	Threats	Safeguards
Audit related			
Certification of Housing Benefit grant	24,894	Self-Interest (because this is a recurring fee)	Grant Thornton UK LLP were appointed by Public Sector Audit Appointments Ltd (PSAA) to undertake this work on behalf of the London Borough of Croydon and this engagement is subject to PSAA's ethical compliance regime. The expected fee for this work is the scale fee set by PSAA and will be subject to variation based upon the level of additional housing benefit testing identified as required. The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work is £24,894 in comparison to the total fee for the audit of £172,860 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee (subject to variation depending on the level of additional housing benefit testing identified as required); there is no contingent element to it. These factors all mitigate the perceived self-interest threat to an acceptable level.
Non-audit related			
CFO Insights subscription	10,000	Self-Interest (because this is a recurring fee)	The fee is a recurrent subscription and thus gives high self-interest threat. However, the fee for this work is negligible in comparison to the total fee for the audit and in particular Grant Thornton UK LLP's turnover overall. It is also a fixed fee with no contingent element. We consider that these factors all mitigate the perceived self-interest threat to an acceptable level. CFO Insights does not provide any advice; the tool provides only information and insight that to help inform decision making by officers. It is the responsibility of your officers who use this service to undertake informed interpretation of the information provided. The team that operates this service is separate to the audit team.

The amounts detailed are fees agreed to-date for audit related and non-audit services to be undertaken by Grant Thornton UK LLP in the current financial year. These services are consistent with the Council's policy on the allotment of non-audit work to your. None of the services provided are subject to contingent fees.

We do not believe that the previous services detailed above will impact our independence as auditors.

Action plan

We have identified 6 of recommendations for the Council as a result of issues identified during the course of our audit. We have agreed our recommendations with management and we will report on progress on these recommendations during the course of the 2018/19 audit. The matters reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with auditing standards.

	Assessment	Issue and risk	Recommendations
1	● Medium	• During the year, the Council established Croydon Affordable Homes LLP to manage a portfolio of affordable accommodation. • While detailed consideration was undertaken in relation to the legal and budget implications of the new arrangements, no detailed analysis was undertaken prior to the setup of Croydon Affordable Homes in relation to how the transactions arising from the setup of the new LLP should be accounted for within the financial statements. • If the financial reporting implications of complex transactions are not considered prior to them being entered into, there is a risk of unforeseen consequences arising when the year end financial statements are prepared.	• Ensure that when planning for complex transactions going forward, financial reporting advice is sought on the accounting treatment for those transactions within the year end statutory financial statements. **Management response** • Independent external advice was obtained in relation to the legal and financing aspects of these transactions. In future, financial reporting advice will be sought at an appropriate point ahead of complex transactions being undertaken; we will also ensure that we engage external auditors earlier in the process.
2	● Medium	• We identified from review of your revaluations that there were a small number of assets which have not been revalued since 2012. • This falls outside of your accounting policy of revaluing land and buildings on a five-year rolling cycle. • If land and buildings are not revalued on a sufficiently regular basis, then there is a risk of misstatement of the asset valuations reported in the financial statements arising.	• Ensure that all land and buildings assets are revalued at least every five years, in accordance with your accounting policy. **Management response** • Management will put in place a review in January each year to ensure that all land and buildings that aren't de-minimus are revalued at least every five years in accordance with our accounting policy.

Controls
- ● High – Significant effect on control system
- ● Medium – Effect on control system
- ● Low – Best practice

Action plan (continued)

	Assessment	Issue and risk	Recommendations
3	Medium	• In our review of information provided to the valuer it was identified that in the listing of HRA properties provided to the valuer, an incorrect property that had been disposed of had been removed from the listing, and therefore the listing was not entirely representative of the HRA portfolio held. • In addition, it was identified that the valuer's report included a community asset, due to the asset having been incorrectly included on the list to be revalued in the year and the valuer revalued the asset as a result. Under the CIPFA Code of Practice, community assets should be carried at amortised cost and not revalued. Your officers identified this and did not post the revaluation adjustment for this asset the accounts. However this is a further example of a weakness in the information provided to the valuer. • If there are errors in the data sent to your valuer, there is a risk that incorrect valuations could be produced.	• Ensure that data sent to the valuers to support the revaluation of land and buildings is accurate and free from error. **Management response** • Management will review the current process and work with the assets team to ensure that property data sent to the valuers is accurate.

Controls

- High – Significant effect on control system
- Medium – Effect on control system
- Low – Best practice

Action plan (continued)

	Assessment	Issue and risk	Recommendations
4	High	• You should ensure that you continue to take action to prevent overspends from arising for the People department.	**Management response** • It is recognised that across local government there are huge pressures on demand for both adult's and children's social care. Over 80% of councils experienced overspends in 2017/18 and the National Audit Office report on financial sustainability published in March 2018 recognised this as a huge challenge. In 2017/18, the major area of overspend in Croydon was in children's social care. This was clearly made worse by our Ofsted judgement and the increase in demand experienced by the service across the year. Adult social care came within £0.5m of balancing its budget in 2017/18, a huge achievement. • The management structure has been changed in the last few months so that there is no longer a People department; there are now separate children's and adults departments which are given a clearer line of sight and focus for the executive directors. Also, the 2018/19 budget includes £19.5m of growth across both areas and only £5m of savings, reflecting the pressures faced in 2017/18. Work is also ongoing to ensure budget holders receive the right training and support and also that we continue to improve the way we forecast to further align activity, demand and finance information so that we have more accurate projections. • The Financial Strategy 2018/22 will set out the expected demand and demographic pressures on social care as this is clearly the major financial risk to the Council.

Controls
- High – Significant effect on control system
- Medium – Effect on control system
- Low – Best practice

Action plan (continued)

	Assessment	Issue and risk	Recommendations
5	High	• You should ensure that a clear strategy is in place for maintaining your reserves at a sustainable level.	**Management response** • This Council has for over a decade had a low level of reserves compared to other councils in London. The Council's low level of funding compared to inner London boroughs and changing demographics have clearly made this hugely challenging in this period. Earmarked reserves have reduced over the last 2 years and this is principally because they have been used for the purposes they were earmarked for in line with the budget and financial strategy. • As part of the new Financial Strategy for 2018/22 there will be a number of strategies for ensuring reserves are maintained at a sustainable level. Principally these are: – the use of flexible capital receipts to fund transformation; – the earmarking of dividends from Brick by Brick Croydon Limited to reserves; and – the use of surpluses from the collection fund to invest into reserves if required; £4.7m has been identified as part of the 2018/19 budget to go back into reserves as the first stage of this.
6	Medium	• You should identify alternative means for funding transformation expenditure in the longer term once flexible capital receipts are no longer available to fund this expenditure.	**Management response** • As a Council, we have taken the opportunity in 2017/18 to use flexible capital receipts to fund transformation expenditure. This has clearly supported us to deliver revenue savings over the medium term and also helped us invest in longer term projects in social care such as the One Croydon Alliance and Children's improvement. We do anticipate that we will receive £30m+ of additional capital receipts over the period of the next financial strategy covering the period 2018 - 2022 and therefore believe this is still a legitimate way of managing the need for investment in transformation of the Council to ensure we remain financially sustainable in the long term. Clearly, given our low level of reserves, the use of reserves to finance transformation expenditure is not a viable option at this point. This will continue to be kept under review.

Controls

- High – Significant effect on control system
- Medium – Effect on control system
- Low – Best practice

Follow up of prior year recommendations

We identified the following issues in the audit of the London Borough of Croydon's 2016/17 financial statements, which resulted in 8 recommendations being reported in our 2016/17 Audit Findings report. We have followed up on the implementation of our recommendations and note that 7 of the 8 recommendations raised have been resolved.

	Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
1	✓	• There is a variance of £1.6m between Council tax revenues for the Collection Fund between the Northgate revenues system and the general ledger. • If reconciling differences between Northgate and the general ledger are not resolved this could lead to misstatement of Collection Fund revenues recognised within the accounts.	• This variance of £1.6m remains, however management have investigated the cause of this difference and gained satisfaction that it is not indicative of any misstatement. • This is due to historical adjustment posted to the general ledger in 2013/14 to release outstanding credit balances, however the accounts in question were not closed on the Northgate system, resulting in a variance arising.
2	X	• Our review of annual member declarations identified that declarations for five members had not been obtained by your central finance team at the time of commencement of the audit. These were subsequently located and shared with the audit team. • If annual declarations are not obtained then there is a risk that potential related party transactions could remain undisclosed in the financial statements.	• For 2017/18, member declarations have been obtained in respect of all members. However, in respect of your senior officers, declarations were not obtained for two of your senior officers who have since departed the Council.
3	✓	• Our testing of debtors identified one debtor balance where VAT had been incorrectly excluded. Further investigation showed that this arose in an extremely rare set of circumstances.in that it was a manual debtor in a wholly owned subsidiary. We therefore concluded it was not appropriate to extrapolate the error. • If the VAT treatment is not correctly recorded for all debtors then this could lead to misstatement of the accounts and non-compliance with tax legislation.	• No such issues have been identified from our debtors testing completed for 2017/18

Assessment
✓ Action completed
X Not yet addressed

Follow up of prior year recommendations (continued)

	Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
4	✓	• The bad debt provision for Housing Revenue Account rent arrears debtors does not reflect the actual rates of collection of HRA rent arrears experienced in 2016/17 and recent years. • We estimate that were the bad debt provision recalculated based on actual rates of collection then an increase in the provision of between £1m and £2m would be required. • If bad debt provisions are not estimated on an accurate basis then this could lead to misstatement of the accounts.	• For 2017/18 a revised approach has been taken to estimating the bad debt provision for Housing Revenue Account rent arrears debtors. We have noted no concerns from our review of the adequacy of the provision estimate as part of the current year audit.
5	✓	• Our IT auditors performed a review of IT security controls at the Council and at the interface with the shared service provider. Their work highlighted a number of issues. Which are summarised below. A number of default accounts and passwords were in place, and excessive privileges were assigned to those accounts. A review of access rights highlighted a number of separation of duties risks. Users are assigned default or excessive user rights Gaps or weaknesses in audit logs Excessive responsibilities given to system administrator accounts. • We have shared the detailed findings in a separate document to management.	• Improvements in your IT security controls in these areas were noted from the review of our IT auditors for 2017/18.

Assessment
✓ Action completed
X Not yet addressed

Follow up of prior year recommendations (continued)

	Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
6	✓	• Your finance team does not have a clear process for identifying fully depreciated plant and equipment and infrastructure assets that have been taken out of use. • The Council's policy has been to write out of the gross cost and accumulated balance values for such assets once they are fully depreciated, in cases where they do not hold the detailed asset level records to determine whether they are still in use or not. • This is not an approach that is compliant with the CIPFA Code of Practice as it is a requirement to hold assets on the Fixed Asset Register until they are taken out of use rather than until they are fully depreciated. • If assets are written out of the Fixed Asset Register when they are fully depreciated rather than when they are disposed of then this could lead to misstatement in the disclosure note to the accounts, although there is no effect on the main statements	• A clear policy has been introduced for identifying and writing out fully depreciated assets that have been taken out of use.
7	✓	• We noted some differences between the draft bank reconciliation working paper supplied and the cash balance in the accounts. During the audit process your finance team updated the bank reconciliation to provide us with sufficient evidence. • If the bank reconciliation is not clearly documented when initially completed this could lead to errors going unnoticed and lead to delays in the audit process.	• No such issues have been noted from our review of the year end bank reconciliation as at 31 March 2018.

Assessment
✓ Action completed
X Not yet addressed

Follow up of prior year recommendations (continued)

	Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
8	✓	• Supporting documentation was not obtained to support all areas of the Council Tax base calculation for 2016/17. This data is drawn from a live database and no download from the live system of the data used was retained. • We have compared the calculation of the Council Tax base to live data from the Council Tax system and note no material differences, and we are satisfied that the Council tax base calculation was materially correct. • If supporting data for the Council Tax base is not maintained then this could leave the calculation open to challenge.	• For 2017/18, appropriate supporting evidence in respect of the Council Tax base calculation has been retained.

Assessment
✓ Action completed
X Not yet addressed

Audit Adjustments – Council financial statements

We are required to report all non trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management.

Impact of adjusted misstatements – Council financial statements

All adjusted misstatements are set out in detail below along with the impact on the key statements and the reported net expenditure for the year.

	Detail	Comprehensive Income and Expenditure Statement £‘000	Balance Sheet £’ 000	Impact on total net expenditure £’000
1	Correction of accounting for lease premium received in respect of the setup of Croydon Affordable Homes LLP: - DR provisions - £2,000k - CR cost of services income: Place - £2,000k	£(2,000)	£2,000	£(2,000)
2	Correction of classification of revaluation gains taken to surplus / deficit on provision of services: - DR other operating expenditure - £45,454k - CR cost of services - £45,454k	£45,454 £(45,454)	No impact	No impact
	Overall impact	**£(2,000)**	**£2,000**	**£(2,000)**

Other omissions	Detail	Adjusted?
Movement in Reserves Statement (MIRS)	• Within the Movement in Reserves Statement, a column should be included to provide a total for the combined value of total General Fund and Earmarked General Fund Reserves. This is also applicable to the group MIRS.	✓
Comprehensive Income and Expenditure Statements (CIES)	• Within the Comprehensive Income and Expenditure Statement, no prior year comparative figures were disclosed for gross income and gross expenditure within cost of services. This is also applicable to the group CIES.	✓
Balance Sheet	• On the Balance Sheet, a sub-total should be added to show the total value of operational and non-operational property, plant and equipment.	✓
Collection Fund	• On the Collection Fund, no prior year comparative disclosure was provided of the split of the prior year comparatives between Business Rates and Council Tax.	✓

Audit Adjustments – group financial statements

Impact of adjusted misstatements – group financial statements

All adjusted misstatements are set out in detail below along with the impact on the key statements and the reported net expenditure for the year.

	Detail	Comprehensive Income and Expenditure Statement £'000	Balance Sheet £' 000	Impact on total net expenditure £'000
1	Correction of classification of work in progress property assets: - DR inventories- £30,050k - CR assets held for sale - £30,050k	No impact	£30,050k £(30,050)k	No impact
2	Correction of adjustment to consolidate Brick By Brick Croydon Limited: - DR inventories - £4,531k - CR long term borrowings - £4,531k - DR general fund - £2,573k - CR bank overdraft - £2,573k	No impact	£4,531k £(4,531)k £2,573k £(2,573)k	No impact
3	Correction of accounting for lease premium received in respect of the setup of Croydon Affordable Homes LLP: - DR provisions - £2,000k - CR cost of services income: Place - £2,000k	£(2,000)	£2,000	£(2,000)
4	Correction of classification of revaluation gains taken to surplus / deficit on provision of services: - DR other operating expenditure - £45,454k - CR cost of services - £45,454k	£45,454 £(45,454)	No impact	No impact
	Overall impact	**£(2,000)**	**£2,000**	**£(2,000)**

Other omission	Detail	Adjusted?
Group Movement in Reserves Statement	• The group movement in reserves statement did not include line items for 'adjustments between group accounts and authority accounts' and 'net increase or decrease before the transfers', as is required by the CIPFA Code of Practice	✓
Group Cash Flow Statement	• The group cash flow statement had been prepared based upon the Council financial statements and did not reconcile to the group cash position.	✓

Audit Adjustments – Misclassification and disclosure changes

Misclassification and disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

Disclosure omission	Detail	Adjusted?
Expenditure and Funding Analysis (EFA)	Within Note 1A 'Expenditure and Funding Analysis', the EFA reconciliation for the General Fund and Housing Revenue Account (HRA) includes line transfers to/from earmarked reserves. As the statutory earmarked reserves form part of the statutory General Fund, the opening and closing General Fund and HRA balances reported in the EFA should include earmarked reserves.	✓
Expenditure and Funding Analysis (EFA)	Within Note 1B 'Note to the Expenditure and Funding Analysis', no description of material reconciling items within the Expenditure and Funding Analysis was provided.	✓
Accounting Policies	Within Note 1.1 'Basis of Preparation – Single Entity and Group Accounts' and Note 40 'Group Interests, it was disclosed that the Council has "joint economic control" of Croydon Affordable Homes LLP. However, your officers have concluded that the Council does not have "joint economic control" of this entity.	✓
Accounting Policies	Note 1.20 'Overheads' had not been updated to reflect the requirements of the revised structure of the Comprehensive Income and Expenditure Statement introduced in 2016/17.	✓
Accounting Policies	Note 1.21 'Schools' did not clarify that the transfer of school land and buildings is accounted for as a loss on disposal of an asset, or of the fact that the schools are consolidated in the Council's accounts, including the income, expenditure, surplus or deficit of each school. The note also did not clarify how management have considered the Council's rights and obligations in respect of school land and buildings in assessing which school assets to recognise on the Balance Sheet.	✓
Critical Judgements In Applying Accounting Policies	Within Note 4 'Critical Judgements In Applying Accounting Policies', no disclosure was provided of the judgement that the leases entered into with Croydon Affordable Homes LLP have resulted in the transfer of control of the properties.	✓
Material Items of Income and Expense	Within Note 5 'Material Items of Income and Expense and Prior Period Adjustments', no disclosure was provided of the accounting treatment for the pension early prepayment.	✓
Adjustments Between Accounting Basis and Funding Basis under Regulations	Within Note 7 'Adjustments Between Accounting Basis and Funding Basis under Regulations', the adjustment to reverse out employer' pensions contributions and direct payments to pensioners payable in the year of £19,221k was included in the figure reported for the 'reversal of items relating to retirement benefits debited or credited to the Expenditure throughout for consistency' line and the 'reversal of items relating to retirement benefits debited or credited to the Expenditure throughout for consistency' line incorrectly reported as nil.	✓
Taxation and Non-Specific Grant Income	Within Note 11 'Taxation and Non-Specific Grant Income' and Note 31 'Grant Income', Council Tax Income is overstated by £35,305k and National Non-Domestic Rates (NNDR) income is understated by £35,305k.	✓
Property, Plant and Equipment	No disclosure was provided within Note 12 'Property, Plant and Equipment' of the significant assumptions made in estimating the valuation of land and buildings.	✓

Audit Adjustments – Misclassification and disclosure changes

Disclosure omission	Detail	Adjusted?
Property, Plant and Equipment	Within Note 12 'Property, Plant and Equipment' no prior period comparatives were provided in relation to the fair value hierarchy disclosure table.	✓
Property, Plant and Equipment	Within Note 12 'Property, Plant and Equipment' no disclosure was provided of the effective dates of revaluation of land and buildings.	✓
Financial Instruments	Within Note 16 'Financial Instruments' the bank overdraft is disclosed as being a Level 1 financial liability, however it is a Level 2 financial liability.	✓
Financial Instruments	Within Note 16 'Financial Instruments' the value for total PWLB borrowings is understated by £6,000k and other borrowings are overstated by £6,000k.	✓
Financial Instruments	Within Note 16 'Financial Instruments' the disclosure of long term debtors reported in the note should be adjusted from £54,895k rather than £46,696k to £54,895k to be consistent with the Balance Sheet The prior year figure for long term debtors should be changed from nil to £22,619k to be consistent with the Balance Sheet.	✓
Financial Instruments	Within Note 16 'Financial Instruments' no disclosure was provided of the fair value of Private Finance Initiative (PFI) liabilities.	✓
Debtors	We noted that within Note 17 'Debtors, Payments In Advance (PIA) And Allowance For Doubtful Debt', the prior year comparative figures for 2016/17 were restated to rectify an error in the classifications within the note. The heading "restated" should be included above the retated figures and narrative disclosure of the basis of the restatement provided.	✓
Pooled Budgets	Within Note 26 'Pooled Budgets', the London Borough of Croydon's share of the gross income and gross expenditure of the Better Care Fund were disclosed as £10,293k and £10,254k respectively, but should have been stated as £15,803k and £15,764k respectively.	✓
External Audit Costs	Note 29 'External Audit Costs' included disclosure of fees payable to Mazars in respect of certification of claims and returns. As these do not relate specifically to fees paid to the external auditor these fees should not be disclosed in the note.	✓
External Audit Costs	No disclosure was provided within Note 29 'External Audit Costs' or in the group accounts of audit fees of £24k for the statutory audit of Brick By Brick Croydon Limited. We would expect the accounts to include disclosure of total audit fees for all entities consolidated within the group accounts.	✓
Grant Income	No disclosure of Housing Benefit Subsidy Income of £187,026k for 2017/18 and £236,116k for 2016/17 was provided within Note 31 'Grant Income'.	✓
Related Party Transactions	Within Note 32 'Related Party Transactions', the disclosures of transactions in 2017/18 with Academy schools and Stanley People's Initiative should be amended from £6,226k and £0 respectively to £1,267k and £14k and respectively.	✓
Related Party Transactions	No disclosure was provided in Note 32 'Related Party Transactions' of transactions occurring and outstanding balances with Brick By Brick Croydon Limited and other entities within the group.	✓

Audit Adjustments – Misclassification and disclosure changes

Disclosure omission	Detail	Adjusted?
Group Interests	Within Note 40 'Group Interests', no disclosure was provided of the Council's interests in Croydon Care Solutions Ltd and its subsidiaries, London Borough of Croydon Holdings LLP and Croydon Holdings Ltd.	✓
Group Accounts	The group accounts should be referenced as being primary financial statements rather than supplementary financial statements.	✓
Notes Regarding the Group Accounts	Within the 'Notes Regarding the Group Accounts', no accounting policy is disclosed in respect of property work in progress assets of Brick By Brick Croydon Limited	✓
Notes Regarding the Group Accounts	Within the 'Notes Regarding the Group Accounts', no disclosure note has been provided in respect of the property work in progress assets of Brick By Brick Croydon Limited.	✓

Fees

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

Audit Fees

	Proposed fee	Final fee
Council Audit – scale fee	£172,860	£172,860
Council Audit – response to objection by a local elector to the 2016-17 financial statements	£40,000	TBC
Audit of Brick By Brick Croydon Limited	£24,000	£24,000
Grant Certification	£24,894	£24,894
Total audit fees (excluding VAT)	**£261,754**	**£261,754**

The proposed fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA).

We have proposed an additional fee of £40,000 in respect of our response to following up an objection made by a local elector to the financial statements for the year ended 31 March 2017. This fee is an estimate and the final fee will be confirmed on completion of our response to the objection and will be subject to agreement by PSAA.

Our fees for grant certification cover only housing benefit subsidy certification, which falls under the remit of Public Sector Audit Appointments Limited. Fees in respect of other grant work, such as reasonable assurance reports, are shown under 'Fees for other services'.

Non Audit Fees

Fees for other services	Fees £'000
Non-audit services	
CFO Insights subscription	£10,000
	£10,000

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