

The Annual Audit Letter for London Borough of Lewisham

Year ended 31 March 2016

October 2016

Darren Wels

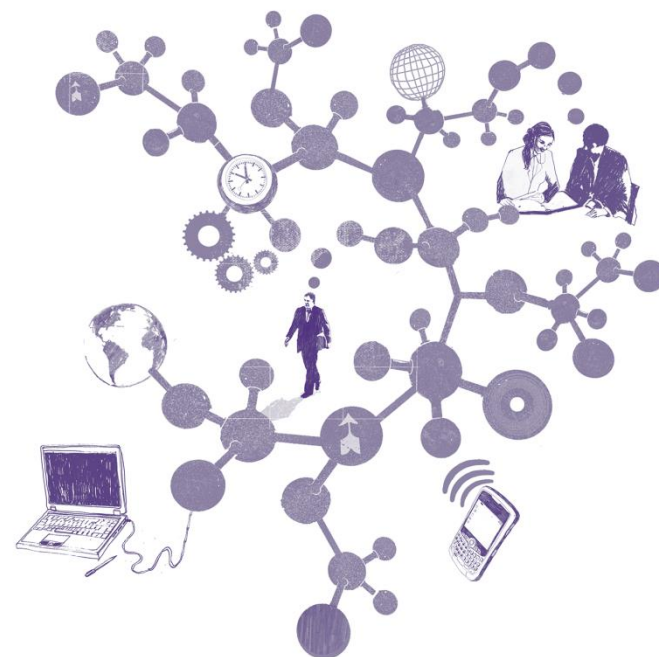
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Executive summary

Purpose of this letter

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

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

We reported the detailed findings from our audit work to the Council's Audit Panel as those charged with governance in our Audit Findings Report on 13 September.

Our responsibilities

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

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

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

Our work

Financial statements opinion

We gave an unqualified opinion on the Council's financial statements on 26 September 2016.

Value for money conclusion

We concluded that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources during the year ended 31 March 2016. We reflected this in our audit opinion on 26 September 2016.

Whole of government accounts

We completed work on the Council's consolidation return following guidance issued by the NAO and issued an unqualified report on 14 October 2016.

Certificate

We certified the completion of the audit of the accounts of London Borough of Lewisham in accordance with the requirements of the Code on 20 October 2016.

Certification of grants

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

Working with the Council

We are continuing to work with the Council management as they look to improve the accounts closedown process in line with the earlier accounts deadlines, which come into force in 2018.

We will also continue to work with the Council as it looks to improve its financial control environment and achieve greater efficiencies and financial sustainability through service transformation.

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

Grant Thornton UK LLP
October 2016

Audit of the accounts

Our audit approach

Materiality

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

We determined materiality for our audit of the Council's accounts to be £18,558,000, which is 1.75% of the Council's gross revenue expenditure. We used this benchmark, as in our view, users of the Council's accounts are most interested in how it has spent the income it has raised from taxation and grants during the year.

We also set a lower level of specific materiality for certain areas, namely cash and senior officers remuneration disclosures.

We set a lower threshold of £927,000, above which we reported errors to the Audit Panel Committee in our Audit Findings Report.

Pension Fund

For the audit of the Lewisham Pension Fund accounts, we determined materiality to be £10,426,000, which is 1% of the Fund's net assets. We used this benchmark, as in our view, users of the Pension Fund accounts are most interested in the value of assets available to fund pension benefits.

We set a lower level of specific materiality for certain areas namely cash and related party transactions. We set a threshold of £521,000 above which we reported errors to the Audit Panel.

The scope of our audit

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

This includes assessing whether:

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

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

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

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

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

Audit of the accounts

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

Risks identified in our audit plan	How we responded to the risk
<p>Valuation of property, plant and equipment The Code requires the Council to ensure the carrying value at the balance sheet date is not materially different from current value. The Council considers the current value of its PPE assets annually, undertaking revaluations where deemed necessary to ensure that the PPE balance is fairly stated. This represents a significant estimate by management in the financial statements.</p>	<p>We completed the following work:</p> <ul style="list-style-type: none"> • Review of the competence, expertise and objectivity of any management experts used; • Walkthrough the system for PPE valuation; • Review of management's processes and assumptions for the calculation of the estimate; • Review of the instructions issued to valuation experts and the scope of their work; • Discussions about the basis on which the valuation is carried out and challenge of the key assumptions; • Review and challenge of the information used by the valuer to ensure it is robust and consistent with our understanding; • Testing of revaluations made during the year to ensure they are input correctly into the Council's asset register; • Evaluation of the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value. <p>The draft financial statements contained a number of significant errors in the accounting treatment of valuations, which management corrected in the final version of the accounts.</p>
<p>Operating expenses Operating expenses understated.</p>	<p>We completed the following work:</p> <ul style="list-style-type: none"> • Walkthrough of operating expenses system, updating our understanding; • Review and test the year end creditors control account reconciliation; • Test a sample of transactions at the year end to confirm they are accounted for in the correct period (cut-off testing); • Review of the accruals policy and confirm that it has been properly applied. <p>We tested an extended sample of operating expenditure and creditors in response to control weaknesses identified by internal audit during the year. We identified a number of errors in our testing, however these were not material to our opinion.</p>

Audit of the accounts – Pension Fund

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

Risks identified in our audit plan	How we responded to the risk
<p>Valuation of level 3 investments Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.</p>	<p>As part of our work we:</p> <ul style="list-style-type: none"> • carried out walkthrough tests of the controls identified in the cycle; • tested a sample of private equity investments by obtaining and reviewing the latest audited accounts for individual investments and agreeing these to the fund manager reports at that date. Reconciliation of those values to the values at 31s March with reference to known movements in the intervening period; • reviewed the qualifications of fund managers as experts to value the level 3 investments at year end and gain an understanding of how the valuation of these investments has been reached; • reviewed the nature and basis of estimated values and considered what assurance management has over the year end valuations provided for these types of investments. <p>Our work did not identify any issues in respect of the risk identified.</p>
<p>Valuation of pension fund net liability The Council's pension fund asset and liability as reflected in its balance sheet represent significant estimates in the financial statements.</p>	<p>We completed the following work:</p> <ul style="list-style-type: none"> • identified the controls put in place by management to ensure the pension fund liability is not materially misstated. We assessed whether these controls were implemented as expected and sufficient to mitigate the risk of material misstatement; • reviewed the competence, expertise and objectivity of the actuary who carried out the pension fund valuation; • completed procedures to confirm the reasonableness of the actuarial assumptions made; • reviewed the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial report from your actuary. <p>Our work did not identify any issues in respect of the risk identified.</p>

Audit of the accounts

Audit opinion

We gave an unqualified opinion on the Council's accounts on 26 September 2016, in advance of the 30 September 2016 national deadline.

Issues arising from the audit of the accounts

We reported the key issues from our audit of the Council's accounts to the Council's Audit Panel on 13th September 2016.

We identified a number of significant adjustments affecting the Council's Comprehensive Income and Expenditure statement and balance sheet. None of these errors affected the overall performance against the Council's revenue budget, although there are several which affect reported income and expenditure and asset values. The main categories of errors were as follows.

- Errors in the Council's accounting treatment of Property, Plant and Equipment, leading to some significant adjustments;
- The Council had not accounted correctly for NNDR in the collection fund; This required multiple adjustments affecting all of the primary financial statements.
- There were several errors in the accounting treatment of grant income.

Internal financial controls

We also had due regard in our testing strategy to the control weaknesses raised by internal audit and in the Head of Internal Audit opinion, particularly in relation to the accounts payable system which received a "no assurance" opinion. To mitigate this risk we tested a larger sample of expenditure, with a focus on the robustness of the supporting evidence.

Although ours was not specifically an audit of controls, our observations during the audit were consistent with those of internal audit. We noted weaknesses in access, separation of duties and authorisation. The number of staff in the finance team has reduced significantly in recent years. Additionally the Council moved to a shared financial services system in 2014. It is not clear that the Council has maintained a full and compliant system of internal control following these changes. The Council should re-evaluate its control framework and ensure new ways of working are understood and complied with by staff.

Closedown arrangements

From 2017/18 all councils in England will be required to publish their audited financial statements by 31st July (currently 30 September). For an organisation as large and complex as the London Borough of Lewisham this will be a significant challenge, requiring a major review of working arrangements.

In early 2016 we discussed this issue with the whole finance team and agreed to treat the 2015/16 audit as a 'dry run' for the earlier closedown. The Council successfully produced draft financial statements by 31 May, in line with the timetable agreed with management. Working papers were made available either at the start of our audit or when requested. By the end of July the audit was substantially further advanced than in the previous year.

However the target of completing the audit by the end of July was not achieved and some work had to be deferred to September. This was because of the volume of issues which arose and the Council's limited capacity to deal with the audit work in the shorter timescale. We have been in discussions with the finance team over lessons learned from this dry run and in particular how more capacity can be added to the finance team to complete the audit in a shorter and earlier timescale. Additional finance capacity during the audit would enable the Council to respond more quickly to queries, enabling the audit team to complete its work in a more efficient manner.

Audit of Accounts

Pension fund accounts

We also reported the key issues from our audit of accounts of the Lewisham Pension Fund to the Council's Audit Panel on 13 September. The Pension fund financial statements were of a good standard. Management responded promptly to our audit queries.

Annual Governance Statement and Narrative Report

We are also required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website with the draft accounts in line with the national deadlines.

Both documents were prepared in line with the relevant guidance and were consistent with the supporting evidence provided and with our knowledge of the Council.

Whole of Government Accounts (WGA)

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

Other statutory duties

We have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

We did not exercise any of these powers or duties in 2015/16.

Value for Money conclusion

Background

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

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

Key findings

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

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

A recurring theme in our discussions with management was the challenge of freeing management capacity to deal with significant transformational change. As part of our Audit Findings report agreed with the Council in September 2016, we agreed a recommendations to address this finding.

Overall VfM conclusion

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

Value for Money

Table 2: Value for money risks

Risk identified	Work carried out	Findings and conclusions
<p>Health & Social Care Integration - The Council is working with partners in the local health economy towards greater health and social care integration. However the health economy is in significant financial difficulty which could create cost pressures for the Council and affect the Council's plans and assumptions around the Better Care Fund, social care funding and public health.</p>	<p>We reviewed the Council's plans and assumptions around health and social care integration particularly concerning the Better Care Fund. We considered how the Council is managing associated cost pressures through working in partnership with local health bodies.</p>	<p>The Council is a relatively high spender on Adult Social Care according to its own benchmarking information. The Council has been working closely with local health services, particularly around the Better Care Fund monies allocated to social care. The Council has made good progress in developing defined savings schemes. The schedule of developed savings schemes for 2017/18 presented in the budget, included almost £3 million of the £5.9million required from social care for the year 2017/18. The remainder are being developed for further review and approval and officers expect them to be fully developed by the time the budget is signed off in February 2017.</p> <p>On that basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements</p>
<p>Financial control - the Council transferred to a financial shared service provider in 2014/15 and also to a new internal audit provider. At the same time there have been staffing reductions within the Council. IA have issued a number of limited or no assurance reports and the Head of IA opinion gave limited assurance.</p>	<p>We considered the Council's arrangements to maintain a sound financial control environment during a period of significant change. We also considered working arrangements with the shared service provider. We reviewed how the Council is responding to issues raised by its internal auditors.</p>	<p>While acknowledging there have been significant control issues in 2015/16 we have not identified material errors in our 2015/16 audit resulting from those control issues. Additionally management are responding to the issues raised.</p> <p>On that basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements</p>
<p>Maintaining quality of service provision - The Council has had to implement significant reductions in staff numbers over the last three years as a result of significant reductions in external funding. There is a risk that these impact on service quality and continuity.</p>	<p>We considered the Council's arrangements to minimise the impact of cuts on service provision. We did this through:</p> <ul style="list-style-type: none"> -discussions with management -review of reports or comments, if any, from external regulators -review of benchmarking data of Council performance against other similar organisations 	<p>The Council has reported mixed performance against achieving its corporate priorities as at the 31 March 2016 year end. However none of these areas of weaker performance can be directly attributed to the impact of savings plans implementation. From our benchmarking data we noted that neighbouring councils are affected by similar trends</p> <p>On that basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements</p>

Value for Money

Table 2: Value for money risks

Risk identified	Work carried out	Findings and conclusions
<p>In year financial management and monitoring - the Council overspent against its 2015/16 budget and had to draw on reserves, which is not sustainable in the long term. The Council faces similar budget pressures in 2016/17</p>	<p>We reviewed the cost pressures facing the Council in the current year, its response to these and its arrangements for managing them. We considered the Council's intentions, approach and strategy towards its use of reserves.</p>	<p>There was an overspend on service budgets in 2015/16 of £6.3 million, which was in line with forecasts. However, as in past years the corporate finance team has implemented planned mitigating action to maintain a balanced financial position overall. The Council recognises that despite the resilience provided by reserves and budgeted contingencies, it cannot continue to incur budget overspends indefinitely.</p> <p>The Council has adequate reserves set aside to provide a buffer against budget overspends, and only a fraction of these were used in 2015/16.</p> <p>On that basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements</p>
<p>Medium term financial planning - The Council estimates that it needs to achieve £45 million of recurring savings or additional recurring income over the next three years. This is a significant challenge following on from efficiencies already made.</p>	<p>The Council presented its budget and savings proposals in July. We reviewed these proposals, considered how realistic they are and considered the arrangements that are in place to implement them. We considered the Council's plans for commercialisation and how these are contributing to the financial strategy.</p>	<p>The Council has a good track record of delivering cost efficiencies. As noted above, the Council has significant reserves set aside to provide a buffer against budget overspends, and in addition, there are a number of areas of discretionary spend that could be used if alternative schemes can not be found. Therefore the Council has financial resilience to set a balanced budget for the foreseeable future.</p> <p>Management believe that future savings will have to focus much more on service transformation, rather than efficiency savings. Management acknowledge that service managers do find it difficult to free up time for thinking and developing ideas, from business as usual demands.</p> <p>To support the established work of the Lewisham Future Programme in 2015 the Council adopted its Lewisham 2020 strategy, which was developed around a large scale consultation with the community (the Big Budget Challenge). This focuses on four themes for transformation and enabling approaches to support the implementation of service reductions, which are summarised in the efficiency plan.</p> <p>On that basis we concluded that the risk was sufficiently mitigated and the Council has proper arrangements</p>

Working with the Council

Our work with you in 2015/16

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

An efficient audit – we delivered the accounts audit 3 days before the deadline. By the end of July the audit was substantially further advanced than in the previous year. Our audit team are knowledgeable and experienced in your financial accounts and systems. Our relationship with your team provides you with a financial statements audit that continues to finish ahead of schedule releasing your finance team for other important work.

Improved financial processes – during the year we discussed how you should respond to weaknesses in your systems of control identified by internal audit.

Understanding your operational health – through the value for money conclusion we provided you with assurance on your operational effectiveness. We highlighted the need to create management capacity to effect transformational change.

Sharing our insight – we provided regular audit committee updates covering best practice. Areas we covered included, Knowing the Ropes – Audit Committee; Effectiveness Review, Making devolution work, Reforging local government]. We have also shared with you our insights on advanced closure of local authority accounts, in our publication "Transforming the financial reporting of local authority accounts" and will continue to provide you with our insights as you bring forward your production of your year-end accounts.

Appendix A: Reports issued and fees

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

Fees

	Planned £	Actual fees £	2014/15 fees £
Statutory audit of Council	193,233	193,233	255,044
Statutory audit of Pension Fund	21,000	21,000	21,000
Housing Benefit Grant Certification	25,569	TBC	39,980
Total fees (excluding VAT)	239,802	TBC	316,024

Fees for other services

Service	Fees £
Audit related services:	
• Housing capital receipts	3,000
• Teachers Pension return	6,000
Non-audit services	Nil

Variations to the planned fee are subject to approval by Public Sector Audit Appointments Ltd.

Reports issued

Report	Date issued
Audit Plan	April 2016
Audit Findings Report	September 2016
Pension Fund Audit Findings Report	September 2016
Annual Audit Letter	October 2016



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