LONDON BOROUGH OF BARNET COUNCIL AND PENSION FUND

ANNUAL AUDIT LETTER

Audit for the year ended 31 March 2018

30 November 2018

BDO

EXECUTIVE SUMMARY

PURPOSE OF THE LETTER

This annual audit letter summarises the key issues arising from the work that we have carried out at London Borough of Barnet Council for the year ended 31 March 2018.

It is addressed to the Council but is also intended to communicate the key findings we have identified to key external stakeholders and members of the public.

RESPONSIBILITIES OF AUDITORS AND THE COUNCIL

It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business and that public money is safeguarded and properly accounted for.

Our responsibility is to plan and carry out an audit that meets the requirements of the National Audit Office's (NAO's) Code of Audit Practice (the Code). Under the Code, we are required to report on:

- Our opinion on the Council and Group's financial statements
- Our opinion on the Pension Fund's financial statements
- Whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We recognise the value of your co-operation and support and would like to take this opportunity to express our appreciation for the assistance and co-operation provided during the audit.

BDO LLP

BDO LLP

AUDIT CONCUSIONS

FINANCIAL STATEMENTS

We issued our unmodified opinions on the Council's (and Group) financial statements on 31 July 2018 and the Pension Fund's financial statements on 19 October 2018.

We identified a number of non-trivial misstatements in the Council's (and Group) financial statements that were not corrected and would decrease the Group's surplus on the provision of services by £3.6 million for current year misstatements.

In the Pension fund financial statements, there were non-trivial misstatements that were not corrected and would decrease the net assets by £0.301 million.

USE OF RESOURCES

We issued our qualified conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources on 31 July 2018 referring to the Ofsted inspection rating the Council's Children's services as inadequate during the year ended 31 March 2018.

We were satisfied that the Council has adequate arrangements for setting and monitoring financial budgets, and that it has clearly identified its funding gap and savings requirements through to 2020. There is, however, a cumulative overspend of £32 million forecast by 2022 for which the Council have identified £16.6 million of service related savings and are working to identify further savings.

EXERCISE OF STATUTORY POWERS

Work in on going in relation to objections received although we were satisfied from our review to date that this does not have a material effect on the financial statements or on our value for money conclusion.

FINANCIAL STATEMENTS

OPINIONS	We issued our unmodified opinions on the Council's (and Group) financial statements on 31 July 2018 and the Pension Fund's financial statements on 10 October 2018.
	This means we consider: • The financial statements give a true and fair view of the financial position and its income and expenditure for the year • Have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting 2017/18.

SCOPE OF THE AUDIT

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

This includes an assessment of whether the accounting policies are appropriate to the Council (and Group) and Pension Fund's circumstances and have been consistently applied and adequately disclosed the reasonableness of significant accounting estimates, and the overall presentation of the financial statements.

OUR APPLICATION OF MATERIALITY

We apply the concept of materiality both in planning and performing our audit and in evaluating the effect of misstatements. We consider materiality to be the magnitude by which misstatements, including omissions, could influence the economic decisions of reasonably knowledgeable users that are taken on the basis of the financial statements.

The materiality for the Council's (and Group) financial statements was set at £15.5 million. This was determined with reference to a benchmark of gross expenditure (of which it represents 1.5 per cent) which we consider to be one of the principal considerations for assessing financial performance.

The materiality for the Pension Fund's financial statements was set at £10.9 million. This was determined with reference to a benchmark of net assets (of which it represents 1 per cent) which we consider to be one of the principal considerations for the pension fund in assessing financial performance. We set a lower materiality level £2.95 million for the transactions included in the Fund Account of the Pension Fund.

OUR ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

Our audit was scoped by obtaining an understanding of the Council (and Group) and Pension Fund and its environment, including the system of internal control, and assessing the risks of material misstatement in the financial statements. We set out below the risks that had the greatest effect on our audit strategy, the allocation of resources in the audit, and the direction of the efforts of the audit team.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	CONCLUSION
Management override of controls	Under auditing standards, there is a presumed risk of management override of controls as management is in a unique position to manipulate accounting records to prepare fraudulent financial statements. We responded to this risk by testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. We reviewed the accounting estimates for bias and evaluated whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. We obtained an understanding of the business rationale for significant transactions that were outside the normal course of business or appeared to be unusual.	No issues were identified by our audit work from our review of journals and review accounting estimates for management bias. We found no significant transactions that were outside the normal course of business or otherwise appear unusual.
Revenue recognition	Under auditing standards there is a presumption that income recognition presents a fraud risk. We responded to this risk by testing an increased sample of grants subject to performance conditions to confirm that conditions of the grant had been met before the income is recognised.	Our testing confirmed that income was valid and agreed to underlying documentation, that grants were recognised only when performance conditions had been met, and income had been recorded in the correct period.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	CONCLUSION
Valuation of land, buildings, dwellings and investment property	Due to the significant value of the Council's property assets, and the high degree of estimation uncertainty, there is a significant risk over the valuation of land, buildings, dwellings and investment properties where valuations are based on assumptions or where updated valuations have not been provided for a class of assets at the year-end. We responded to this risk by: • Reviewing the instructions provided to the valuer and assessing their expertise. • Checking the basis of valuation for assets valued in year as appropriate and agreeing data used by the valuer to support the valuations. • Reviewed the reasonableness of assumptions used in the valuations against indices and price movements for classes of assets, and followed up valuation movements that appeared unusual against indices.	We concluded that we could rely upon the work of the valuer and that the basis of the valuation of assets was appropriate. We were satisfied with the accuracy of the asset information provided to the valuer. We challenged the valuer in respect of a number of property valuation movements and were satisfied with the valuations. Council dwellings valuations increased by 6%. We compared this to house price indices which show prices within London dropping by 0.7%. We reported in recent years that the Council had not been applying valuation increases by as much as regional price indices would suggest and that we were of the view that the valuations in previous years (while still within a reasonable range) had moved toward the prudent end. The increase in the current year, based on actual sales of comparable dwellings, appears to have an element of 'catch up' for previous years and is likely to have moved the valuations back towards the middle of the estimation range. This year, the Council has reduced the estimation for rebuild costs for schools from the sizing applied previously (and now in line with minimum government requirements) and reduced the rebuild costs per square metre (now using the upper quartile BCIS regional prices). This resulted in a valuation decrease of 2.7% to schools' land and buildings. Investment properties increased due to a number of assets being part of redevelopment schemes, most notably around the Brent Cross redevelopment, and revaluations include higher land values. Surplus assets increased in value where the land had been earmarked for potential residential redevelopment sites. Other land and buildings reduced in value mainly due to the reduction in value for the Abbots Depot site and Copthall site although libraries increased where the valuer had used higher land values.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	CONCLUSION
Valuation of pension liability	There is a risk the membership data and cash flows provided to the actuary at 31 March may not be correct, or the valuation uses inappropriate assumptions to value the liability. We responded to this risk by: • Agreeing the information provided to the actuary for contributions and investment returns for the year. • Reviewing the roll-forward membership data from the 2016 triennial valuation used to update the liability valuation. • Reviewing the reasonableness of the assumptions used in the calculation against other local government actuaries and other observable data.	The Council's net pension liabilities increased by £2.5 million to £535.1 million (Group liability £566 million), including unfunded promised benefits, compared to the previous year. The total value of promised pension benefits in the pension fund increased to £1,864 million against investment assets of £1,097 million. The majority of assumptions remained consistent between the years other than an increase in the discount rate (this reduced the liability). The increased net liability mainly comprised an increase for current service costs that (along with interest costs) exceeded contributions paid by the Council. This was offset by a reduction in liabilities from the change to the discount rate and higher than expected return on scheme investments. We agreed the information provided to the actuary for contributions paid to the pension fund and investment returns for the year. We noted differences in the final investment returns and fund valuation than had been estimated by the actuary and the Council's share of the fund assets was potentially understated by £1.9 million. Our review of the 2016 triennial membership data used in the roll-forward valuation found that some members with incomplete records that had been assumed to be deferred members were active members. The actuary has estimated that this would increase the Council's liability by £2.3 million. We also found some errors in the data held for members and the Council is undertaking a significant data cleansing exercise to improve record keeping. There have also been a number of staff transfers to academies and other organisations as a result of outsourcing contracts since 2016 but no adjustment has been made to the total assets and liabilities allocated to the Council. The actuary has stated that the number of staff transferring is not significant and would not have a material impact on the net liability of the Council. Adjustments will be made in the 2019 triennial valuation for these transfers to other employers. We are satisfied that these differences arising from the use of the rolled-forward 2016 data is does not result in a material misstatement of the net liability. Our review of assumptions used to estimate the value the pension liability were found to be reasonable.

USE OF RESOURCES

CONCLUSION	We issued our qualified conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources on 31 July 2018 referring to the Ofsted inspection rating the Council's Children's services as inadequate during the year ended 31 March 2018.
	This means we consider that the Council has proper arrangements to deploy resources to achieve planned and sustainable outcomes for taxpayers and local people, but there are weaknesses in the arrangements for: • Understanding and using appropriate reliable financial and performance information (including information from regulatory bodies) • Informed decision making and performance management • Organising and developing the workforce effectively to deliver strategic priorities.

SCOPE OF THE AUDIT

We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources.

As part of reaching our overall conclusion we consider the following sub criteria in our work: informed decision making, sustainable resource deployment, and working with partners and other third parties.

OUR ASSESSMENT OF SIGNIFICANT RISKS

Our audit was scoped by our cumulative knowledge brought forward from previous audits, relevant findings from work undertaken in support of the opinion on financial statements, reports from the Council including internal audit, information disclosed or available to support the annual governance statement, and information available from the risk registers and supporting arrangements.

We set out below the risks that had the greatest effect on our audit strategy, the allocation of resources in the audit, and the direction of the efforts of the audit team.

USE OF RESOURCES

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	CONCLUSION
Financial sustainability	The Council identified that the continued support from reserves would not be viable and the Medium Term Financial Strategy (MTFS) updated in December 2017 to show a forecast budget gap prior to identified savings of £39.5 million over the 2-year period from 2018/19 to 2019/20. The Council identified savings plans in order to address this budget gap in 2018/19 however a £5.9 million gap is currently forecast for 2019/20. The savings targets were significant and achievement of these inherently challenging. Initial horizon planning suggested that there may be a further £32.5 million of cost pressures in 2020/21 and this would need to be covered from reserves and additional savings plans to be identified. We responded to this risk by reviewing the assumptions used in the MTFS. We also reviewed the current savings and the budgeted savings to close the budget gap after 2018/19.	The MTFS has been refreshed and balanced for 2018/19 with planned drawdown from reserves of £7.7 million. There is, however, a cumulative overspend of £32 million forecast by 2022 for which the Council has identified £16.6 million of service related savings and are working to identify further savings. There are regular meetings taking place where savings plans, pressures and mitigations are being discussed with progress tracked, actions planned and budget owners held to account. There are still risks that some of the pressures have been under estimated and some of the mitigations could be too optimistic. There are plans in place to deliver the required savings for 2018/19 and 2019/20 with a few of these already materialising, although there remains a risks that other savings may not materialise, some of which have been identified and other options being considered. The Council is currently working through a long list of possible savings for the years 2020-2024 with a proposed savings plan being prepared for consideration later this year. The reserves forecast shows available (non ring-fenced) reserves of £38 million up to 2020 with forecast drawdown being £4 million for 2018/19 and £3.7 million for 2019/20. While there has been a lot of change and improvement at the Council in the last 12 months with regards to managing resources and sustainable finances there is still a long way to go. It is paramount that management and members continue to keep the financial sustainability of the Council as a high priority with pressures, mitigations and savings tracked regularly. Reserves need to be protected and not be seen as the fall back. While there is a recognised funding gap in the MTFS, we are satisfied that the Council has appropriate arrangements to continue to remain financially sustainable over the period of the MTFS.

USE OF RESOURCES

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT	CONCLUSION
Quality of Family Services provision	In 2017, the Council was subject to an Ofsted inspection of its services for children in need of help and protection, children looked after and care leavers. The inspection was critical of the Council and found widespread poor practice and failures in arrangements to ensure the safety of children and young people. We responded to this risk over the quality of care provided by Family Services by: • Reviewing the Ofsted Monitoring Reports issued through the year to determine the direction of travel of the services. • Monitored progress against the Family Services Improvement action plan. • Reviewed the minutes of the Children, Education, Libraries and Safeguarding Committee. • Held meetings with key individuals to discuss the direction of travel of the services.	There has been a positive direction of travel during the year in terms of improvements made to Children's Services. However, as Ofsted continues to rate the Council's Children's services as inadequate, we were unable to conclude that the Council has adequate arrangements for the delivery of safe and effective services for Children's services and our use of resources conclusion was qualified to reflect this.

EXERCISE OF STAUTORY POWERS

QUESTIONS AND OBJECTIONS RECEIVED FROM LOCAL ELECTORS

We received the following questions and objections from local taxpayers

ISSUE	FINDINGS
Capita gainshare payments	We received an objection relating to gainshare of £500,000 paid to Capita in 2017/18 under the London Highways Alliance (LoHAC) contract where the objector alleges that these payments are unlawful and that the payments should not have been made. There is also a similar objection that remains under review relating other gainshare payments to Capita of £313,215 for savings on energy costs contracts and £1,241,476 for savings on agency spend in 2016/17. We have issued a Provisional view on the 2016/17 objection on gainshare payments to Capita covering the payments for the agency contract and energy contract of £313,215. We have not upheld the objection to seek a declaration from the courts for the lawfulness of the payments made nor do we intend to issue a Public Interest Report as requested by the objector. However, we intend to report that weaknesses were identified in the arrangements to challenge the basis of calculating gainshare that operated in financial year 2016/17. Work is currently in progress to review the lawfulness of the gainshare payments made under the LoHAC contract. We note that the Council has since ceased the gainshare arrangement with Capita and that no amounts will be paid in 2018/19.
Contract extension award for NSL street scene enforcement	We received an objection relating to an extension to the NSL street scene enforcement contract beyond the terms of the original contract award and allowed extension period, and that the value of the extensions exceeded both the Council's delegated levels and the EU procurement limits. The objector has requested that we issue a Public Interest Report in failing to achieve best value and (inferred in the objection) unlawfulness of the contract payments. We have asked the Council for its initial response to the matters raised and await this response before we are able to progress this work. However, it is unlikely that this will have a material impact on the financial statements or use of resources opinions.

APPENDIX

REPORTS ISSUED

We issued the following reports since our previous annual audit letter.

REPORT	DATE
Grant claims and certification 2016/17	15 January 2018
Audit plan Council (and Group) 2017/18	19 April 2018
Audit plan Pension Fund 2017/18	30 May 2018
Audit completion report Council (and Group) 2017/18	31 July 2018
Audit completion report Pension Fund 2017/18	10 October 2018

FEES

We are currently in discussion with management regarding final fees.

AUDIT AREA	FINAL FEES £	PLANNED FEES £
Council (and Group) audit - PSAA scale fee	(1) 197,262	170,025
Pension Fund audit - PSAA scale fee	(2) 43,810	21,000
Housing benefits subsidy certification fee	(3) 21,617	21,617
Fees relating to objections	(4) TBC	N/A
Total audit fees	**262,689**	**212,642**
Pooled housing receipts certification	(3) 2,750	2,750
Teachers pension return certification	(3) 5,000	5,000
Total audit related services fees	**7,750**	**7,750**
Other non-audit services	0	0
Total assurance services fees	**270,439**	**220,642**

(1) Additional work required this year as a result of remapping of CIES, addition testing of valuations and use of resources risks. We propose raising additional fees of £27,237 (to £197,262).

(2) Additional testing required due to poor record keeping, membership data and aged debt. We propose raising additional fees of £22,810 (to £43,810).

(3) Work is in progress on the housing benefits subsidy and other certification returns.

(4) Fees for investigating objections will be chargeable upon completion of this work.

FOR MORE INFORMATION:

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