Grant Thornton

External Audit Plan

Year ending 31 March 2020

London Borough of Sutton Council and London Borough of Sutton Pension Fund

June 2020

Contents

Your key Grant Thornton team members are:

Iain Murray
Engagement Lead
T: 020 7728 3328
E: iain.g.murray@uk.gt.com

Keith Mungadzi
Manager
T: 020 7728 2393
E: keith.mungadzi@uk.gt.com

The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit planning process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Authority or all weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

1. Introduction & headlines

Purpose

This document provides an overview of the planned scope and timing of the statutory audit of the London Borough of Sutton Council ('the Council') and the Sutton Pension Fund ('the Fund') for those charged with governance.

Respective responsibilities

The National Audit Office ('the NAO') has issued a document entitled Code of Audit Practice ('the Code"). This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. Our respective responsibilities are also set out in the Terms of Appointment and Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA), the body responsible for appointing us as auditor of the Authority and the Fund. We draw your attention to both of these documents on the PSAA website.

Scope of our audit

The scope of our audit is set in accordance with the Code and International Standards on Auditing (ISAs) (UK). We are responsible for forming and expressing an opinion on the :

- The Council, Group and Fund's financial statements that have been prepared by management with the oversight of those charged with governance (The Audit and Governance Committee); and
- Value for Money arrangements in place at the Authority, group and Fund for securing economy, efficiency and effectiveness in your use of resources.

The audit of the financial statements does not relieve management or the Audit and Governance Committee of your responsibilities. It is the responsibility of the Authority to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Authority is fulfilling these responsibilities.

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

Group Accounts	The Authority is required to prepare group financial statements that consolidate the financial information of Sutton Housing Partnership Limited, Encompass LATC Ltd and Cognus Ltd (75% owned by Sutton).
Significant risks	Those risks requiring special audit consideration and procedures to address the likelihood of a material financial statement error have been identified as: **London Borough of Sutton** • Management override of controls • Valuation of property, plant and equipment being materially misstated • Valuation of pension fund net liability being materially misstated • Covid-19 Financial Statement Level **Sutton Pension Fund** • Management override of controls • The valuation of Level 3 investment assets being materially misstated We will communicate significant findings on these areas as well as any other significant matters arising from the audit to you in our Audit Findings (ISA 260) Report.

Page 123

Agenda Item 12

1. Introduction & headlines continued

Materiality - Council	We have determined planning materiality to be £7.6m (PY £9.6m) for the Group and £7.2m (£9.3m) for the Council, which equates to approximately 1.5% of your prior year gross expenditure. We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. Clearly trivial has been set at £400k (PY £464k).
Materiality – Pension Fund	We have determined materiality at the planning stage of our audit to be £6.6m (PY £6.4m) for the Fund, which equates to 1% of your net assets for the year. We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. Clearly trivial has been set at £322k (PY £321k).
Value for Money arrangements	Our risk assessment regarding your arrangements to secure value for money have identified the following VFM significant risks: • Budget Management • Savings plans and medium term financial planning – reserves management and financial standing
Audit logistics	Our interim visit took place February and March 2020 and our final visit will take place in June and July. Our key deliverables are this Audit Plan and our Audit Findings Report. Our audit approach is detailed in Appendix A. Our fee for the audit will be £97,603 (PY: £72,603) for the Council, and £25,000 (PY: £16,170) for the Pension Fund, subject to the Authority meeting our requirements set out on pages 20 and 22.
Independence	We have complied with 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.

2. Key matters impacting our audit

Factors

The wider economy and political uncertainty

Local Government funding continues to be stretched with increasing cost pressures and demand from residents, uncertainty of future funding and the impact of COVID-19. 2019/20 is the final year of the '4 year settlement' and since 2018/19 you have been self sufficient in terms of funding as general government grant funding has been reduced to nil which means you are reliant on local taxes, fees and charges and making the most of your capital assets to generate your own income. The London Business Rates Pooling Pilot has continued for a second year however the arrangements are slightly different to year 1, with 100% retention being reduced to 75%.

As part of the response to the COVID-19 pandemic, the government announced £1.6bn in additional funding to Local Authorities to address the pressures of the pandemic. For Sutton, your allocation is £4.5m. The government announced changes to the business rates that mean qualifying businesses will not pay business rates for 2020/21 and Local Authorities will be compensated for the associated loss of income and for the provision of appropriate new burdens funding to cover the administrative costs of implementation.

The government continues its negotiation with the EU over Brexit, and future arrangements remain clouded in uncertainty. The Council will need to ensure that it is prepared for all outcomes, including in terms of any impact on contracts, on service delivery and on its support for local people and businesses.

A balanced budget was set for 2019/20. At the start of the year the general fund balance was £8.4m. The 2019/20 budget included a contribution of £1.1m from the General Fund Balance. The expected year end balance would therefore be £8.1m if the planned outturn position is achieved. As at Quarter 3 you were reporting an anticipated £0.267m underspend.

Financial reporting and audit – raising the bar

The Financial Reporting Council (FRC) has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge, and to undertake more robust testing as detailed in Appendix 1.

Our work in 2018/19 has highlighted areas where local government financial reporting, in particular, property, plant and equipment and pensions, needs to be improved, with a corresponding increase in audit procedures. We have also identified an increase in the complexity of local government financial transactions which require greater audit scrutiny.

Local Government Timetable

The new date for publication for the final, audited 2019/20 Financial Statement is 30 November 2020, a change from the 31 July 2020. The formal 10 working day public inspection period must start by 1 September 2020. The Council will be required to publish the date of their inspection period this year.

IFRS 16

The Public Sector was due to implement the IFRS 16 standard from 1 April 2020 (replacing IAS17 leases). The implementation of IFRS 16 has now been delayed to 1 April 2021 due to COVID-19, however, the Council will still be required to include disclosures in the 2019/2020 financial statements on the expected impact of the standard in accordance with requirement of IAS 8.

Covid 19

The global outbreak of the Covid-19 virus pandemic has led to unprecedented uncertainty for all organisations, requiring urgent business continuity arrangements to be implemented. We expect current circumstances will have an impact on the production and audit of the financial statements for the year ended 31 March 2020

Our response

- We will consider your arrangements for managing and reporting your financial resources as part of our work in reaching our Value for Money conclusion.
- We will consider whether your financial position leads to material uncertainty about the going concern of your group and will review related disclosures in the financial statements.
- We will consider your arrangements for supporting your savings programmes.
- We will continue to engage with Members and Senior Officers to assess how you are performing in addressing your challenges.
- As a firm, we are absolutely committed to meeting the expectations of the FRC with regard to audit quality and local government financial reporting. Our proposed work and fee, as set further in our Audit Plan, has been agreed with the Director of Corporate and Commercial and is subject to PSAA agreement.

Key matters impacting our audit – Pension Fund

Factors

The wider picture and political uncertainty

- Local Government funding continues to be stretched with increasing cost pressures.
- The market value of LGPS funds at end of March 2019 was £287.2 billion (an increase of £16.3 billion or 6.0%) but for the first time, the LGPS in England & Wales is now cashflow negative, with benefit payments rising to £10.4bn while contributions fell to £9.3bn. There are now over 18,000 employers. Local authorities represent around 18.3% of these but have 74% of the members.
- The UK is set to leave the EU on 31 January 2020. The economic impact of this remains uncertain as is the wider global economic picture. The Pension Fund will need to ensure that it's investment strategy has considered potential outcomes.

Governance

- The Scheme Advisory Board (SAB) has published the *Good Governance – Phase II Report*. Proposals include having a single named officer responsible for the delivery of LGPS related activity for a fund, an enhanced annual governance compliance statement and establishing a set of key performance indicators.
- SAB is also consulting on Responsible Investment guidance to assist and help investment decision makers.
- tPR continues to apply pressure on pension schemes to improve the quality of scheme member data. The 2019 valuation process will likely have thrown up some data issues (large or small) that need addressing.

Financial reporting and audit – raising the bar

The Financial Reporting Council (FRC) has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge, and to undertake more robust testing as detailed in Appendix 1.

Triennial LGPS valuation

The local government pension scheme underwent a full triennial valuation as at 31 March 2019. The impact on liabilities and assets of the Fund will be reported for the first time in the 2019/20 financial statements, with forward contributions required being determined from 2020/21 onwards.

Investments

As at end of December 2019, the Fund's value had increased in value to £703.9m. The Fund needs to comply with the asset pooling regulations and to date only 30% of assets has been transitioned to the London CIV on their Authorised Contractual Scheme platform. Further statutory guidance is due in 2020 from the Ministry of Housing, Communities and Local Government (MHCLG) which is expected to state that existing assets should be transitioned quickly to asset pools. An investment strategy review will be undertaken in 2020/21 in the light of the results of the 2019 actuarial valuation.

Our response

- We will consider whether your financial position leads to material uncertainty about the going concern of the Pension Fund and will review related disclosures in the financial statements.

We will consider the Pension Fund's responses to the SAB initiatives and whether they impact upon our risk assessment.

As a firm, we are absolutely committed to meeting the expectations of the FRC with regard to audit quality and financial reporting. Our proposed work and fee, as set further in our Audit Plan, has been agreed with the Director of Corporate and Commercial and is subject to PSAA agreement.

We will discuss with management the audit implications of any changes in investment strategy on our audit.

We will perform additional procedures to gain assurance over the completeness and accuracy of financial and non-financial data provided to the Pension Fund actuary in respect of the triennial valuation, and consider the impact of the updated funding ratio on the Fund's going concern position.

3. Group audit scope and risk assessment

In accordance with ISA (UK) 600, as group auditor we are required to obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Component	Individually Significant?	Audit Scope	Risks identified	Planned audit approach
London Borough of Sutton	Yes		• Management override of controls • Valuation of property, plant and equipment (including Investment Property) • Valuation of pension fund net liability being materially misstated • Covid-19 Financial Statement Risk	Full scope UK statutory audit performed by Grant Thornton UK LLP
Sutton Housing Partnership	No		• Management override of controls • Valuation of pension fund net liability	Audit performed by Grant Thornton UK LLP on one or more classes of transactions, account balances or disclosures relating to significant risks of material misstatement of the group financial statements.

Key changes within the group:

- At the planning stage of our audit there are no expected changes within the group.

Audit scope

- Audit of the financial information of the component using component materiality
- Audit of one more classes of transactions, account balances or disclosures relating to significant risks of material misstatement of the group financial statements
- Review of component's financial information
- Specified audit procedures relating to significant risks of material misstatement of the group financial statements
- Analytical procedures at group level

Page 127

Agenda Item 12

4. Significant risks identified

Significant risks are defined by ISAs (UK) as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement.

Risk	Entity Risk Relates to	Reason for risk identification	Key aspects of our proposed response to the risk
The revenue cycle includes fraudulent transactions (rebutted)	**Council and Pension Fund**	Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition. Having considered the risk factors set out in ISA240 and the nature of your revenue streams, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • There is little incentive to manipulate revenue recognition. • Opportunities to manipulate revenue recognition are very limited. • The culture and ethical frameworks of local authorities, including London Borough of Sutton, mean that all forms of fraud are seen as unacceptable	We do not consider this to be a significant risk for the London Borough of Sutton and Sutton Pension Fund.
Management over-ride of controls	**Council and Pension Fund**	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. The council faces external scrutiny of its spending and this could potentially place management under undue pressure in terms of how they report performance. We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk, which was one of the most significant assessed risks of material misstatement.	We will: • Evaluate the design effectiveness of management controls over journals. • Analyse the journals listing and determine the criteria for selecting high risk unusual journals. • Test unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration. • Gain an understanding of the accounting estimates and critical judgements applied made by management and consider their reasonableness with regard to corroborative evidence. • Evaluate the rationale for any changes in accounting policies, estimates or significant unusual transactions.

Significant risks identified continued

Risk	Entity Risk Relates To	Reason for risk identification	Key aspects of our proposed response to the risk
Covid 19	**Council and Pension Fund**	The global outbreak of the Covid-19 virus pandemic has led to unprecedented uncertainty for all organisations, requiring urgent business continuity arrangements to be implemented. We expect current circumstances will have an impact on the production and audit of the financial statements for the year ended 31 March 2020, including and not limited to; • Remote working arrangements and redeployment of staff to critical front line duties may impact on the quality and timing of the production of the financial statements, and the evidence we can obtain through physical observation • Volatility of financial and property markets will increase the uncertainty of assumptions applied by management to asset valuation, and the reliability of evidence we can obtain to corroborate management estimates • Financial uncertainty will require management to reconsider financial forecasts supporting their going concern assessment and whether material uncertainties for a period of at least 12 months from the anticipated date of approval of the audited financial statements have arisen; and • Disclosures within the financial statements will require significant revision to reflect the unprecedented situation and its impact on the preparation of the financial statements as at 31 March 2020 in accordance with IAS1, particularly in relation to material uncertainties. We therefore identified the global outbreak of the Covid-19 virus as a significant risk, which was one of the most significant assessed risks of material misstatement.	We will: • Work with management to understand the implications the response to the Covid-19 pandemic has on the organisation's ability to prepare the financial statements and update financial forecasts and assess the implications on our audit approach • Liaise with other audit suppliers, regulators and government departments to co-ordinate practical cross sector responses to issues as and when they arise • Evaluate the adequacy of the disclosures in the financial statements in light of the Covid-19 pandemic. • Evaluate whether sufficient audit evidence using alternative approaches can be obtained for the purposes of our audit whilst working remotely • Evaluate whether sufficient audit evidence can be obtained to corroborate management's estimates such as asset valuations and recovery of receivable balances • Evaluate whether sufficient audit evidence can be obtained to corroborate significant management estimates such as Level 3 asset valuations, • Evaluate management's assumptions that underpin the revised financial forecasts and the impact on management's going concern assessment • Discuss with management any potential implications for our audit report if we have been unable to obtain sufficient audit evidence

Page 129

Agenda Item 12

Significant risks identified continued

Risk	Entity Risk Relates To	Reason for risk identification	Key aspects of our proposed response to the risk
Level 3 Investments	**Pension Fund**	By their nature, Level 3 investment valuations lack observable inputs. These valuations therefore represent a significant estimate by management in the financial statements due to the size of the numbers involved (£75 million) and the sensitivity of this estimate to changes in key assumptions Under ISA 315 significant risks often relate to significant nonroutine 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. Management utilise the services of investment managers as valuation experts to estimate the fair value as at 31 March 2020. We therefore identified valuation of Level 3 investments as a significant risk, which was one of the most significant assessed risks of material misstatement.	We will: • gain an understanding of the Fund’s process for valuing level 3 investments and evaluate the design of the associated controls • review the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments; to ensure that the requirements of the Code are met; • consideration of the competence, expertise and objectivity of any management experts used • review the qualification of the expert used to value Level 3 investments at year end and gain an understanding of how the valuation of these investments has been reached; and • for a sample of investments, test the valuation by obtaining and reviewing the audited accounts, (where available) at the latest date for individual investments and agreeing these to the fund manager reports at that date. Reconcile those values to the values at 31 March 2020 with reference to known movements in the intervening period

Significant risks identified continued

Risk	Entity Risk Relates To	Reason for risk identification	Key aspects of our proposed response to the risk
Valuation of land and buildings (including investment properties)	**Council**	The Council revalues its land and buildings on an annual basis to ensure that the carrying value is not materially different from the current value or fair value (for surplus assets) at the financial statements date. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved (£867 million) and the sensitivity of this estimate to changes in key assumptions. Management have engaged the services of their internal valuer to estimate the current value as at 31 March 2020. We therefore identified valuation of land and buildings, particularly revaluations and impairments, as a significant risk, which was one of the most significant assessed risks of material misstatement.	We will: • Evaluate management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work. • Evaluate the competence, capabilities and objectivity of the valuation expert. • Write to the valuer to confirm the basis on which the valuation was carried out to ensure that the requirements of the Code are met. • Test revaluations made during the year to see if they had been input correctly into the Council's asset register and financial statements. • Engage our own valuer to assess the instructions to the Council's valuer, the Council's valuer's report and assumptions that underpin the valuation. • Assess the value of a sample of assets in relation to market rates for comparable properties. • Test a sample of beacon properties in respect of council dwellings to consider whether their valuation assumptions are appropriate and whether they are truly representative of the other properties within that beacon group.
Valuation of the pension fund net liability	**Council**	The Council's pension fund net liability, as reflected in its balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements. The pension fund net liability is considered a significant estimate due to the size of the numbers involved (£357 million in the Council's balance sheet) and the sensitivity of the estimate to changes in key assumptions. We therefore identified valuation of the Authority's pension fund net liability as a significant risk, which was one of the most significant assessed risks of material misstatement.	We will: • Update our understanding of the processes and controls put in place by management to ensure that the Council's pension fund net liability is not materially misstated and evaluate the design of the associated controls. • Evaluate the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work. • Assess the competence, capabilities and objectivity of the actuary who carried out the Council's pension fund valuation. • Assess the reasonableness of the actuary's assumptions and calculations in-line with the relevant standards, including their consideration of the ongoing impact of the McCloud and Guaranteed Minimum Pension cases. • Assess the accuracy and completeness of the information provided by the Council to the actuary to estimate the liability. • Test the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary. • Undertake procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report.

Page 131

Agenda Item 12

5. Other risks identified

Risk	Risk relates to	Reason for risk identification	Key aspects of our proposed response to the risk
Completeness of non-pay operating expenditure and associated short-term creditors	**Council**	Non-pay expenditure on goods and services represents a significant percentage (73%) of your gross operating expenditure. Management uses judgement to estimate accruals of un-invoiced costs. We identified completeness of non- pay expenditure and associated short-term creditors as a risk requiring particular audit attention.	We will: • Evaluate your accounting policy for recognition of non-pay expenditure for appropriateness, including the use of de minimis level set. • Gain an understanding of your system for accounting for non-pay expenditure and evaluate the design of the associated controls. • Obtain and test a listing of non-pay payments made in April and May 2020 to ensure that they have been charged to the appropriate year.

Other risks identified

Risk	Entity Risk Relates To	Reason for risk identification	Key aspects of our proposed response to the risk
Actuarial Present Value of Promised Retirement Benefits	**Pension Fund**	The Fund discloses the Actuarial Present Value of Promised Retirement Benefits within its Notes to the Accounts. This represents a significant estimate in the financial statements. The Actuarial Present Value of Promised Retirement Benefits is considered a significant estimate due to the size of the numbers involved (£1,074m gross liability) and the sensitivity of the estimate to changes in key assumptions. We therefore identified valuation of the Fund's Actuarial Present Value of Promised Retirement Benefits as a risk of material misstatement.	We will: • Update our understanding of the processes and controls put in place by management to ensure that the Fund's Actuarial Present Value of Promised Retirement Benefits is not materially misstated and evaluate the design of the associated controls. • Evaluate the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work. • Assess the competence, capabilities and objectivity of the actuary who carried out the Fund's pension fund valuation. • Assess the accuracy and completeness of the information provided by the Fund to the actuary to estimate the liability. • Test the consistency of disclosures with the actuarial report from the actuary. • Undertake procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report.
Valuation of Level 2 Investments	**Pension Fund**	While level 2 investments do not carry the same level of inherent risks associated with level 3 investments, there is still an element of judgement involved in their valuation as their very nature is such that they cannot be valued directly. We therefore identified the valuation of the Fund's Level 2 investments as a risk of material misstatement.	We will: • Gain an understanding of the Fund's process for valuing Level 2 investments and evaluate the design of the associated controls. • Review the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments. • Review the reconciliation of information provided by the individual fund manager's custodian and the Pension Scheme's own records and seek explanations for variances. • Independently request year-end confirmations from investment managers and custodian. • Review investment manager service auditor report on design effectiveness of internal controls.

Page 133

Agenda Item 12

Other risks identified

Risk	Entity Risk Relates To	Reason for risk identification	Key aspects of our proposed response to the risk
Contributions	**Pension Fund**	Contributions from employers and employees' represents a significant percentage of the Fund's revenue. We therefore identified the completeness and accuracy of the transfer of contributions as a risk of material misstatement.	We will: • Evaluate the Fund's accounting policy for recognition of contributions for appropriateness. • Gain an understanding of the Fund's system for accounting for contribution income and evaluate the design effectiveness of the associated controls. • Agree changes in Admitted/Scheduled bodies to supporting documentation and agree total contributions for each employer to employer contributions reports. • Test a sample of contributions to source data to gain assurance over their accuracy and occurrence. • Test relevant member data to gain assurance over management information to support a predictive analytical review with reference to changes in member body payrolls and the number of contributing pensioners to ensure that any unusual trends are satisfactorily explained.
Pension Benefits Payable	**Pension Fund**	Pension benefits payable represents a significant percentage of the Fund's expenditure. We therefore identified the completeness, accuracy and occurrence of the transfer of pension benefits payable as a risk of material misstatement.	We will: • Evaluate the Fund's accounting policy for recognition of pension benefits expenditure for appropriateness. • Gain an understanding of the Fund's system for accounting for pension benefits expenditure and evaluate the design of the associated controls. • Test a sample of lump sums and associated individual pensions in payment by reference to member files. • Test relevant member data to gain assurance over management information to support a predictive analytical review with reference to changes in pensioner numbers and increases applied in year to ensure that any unusual trends are satisfactorily explained.

We will communicate significant findings on these areas as well as any other significant matters arising from the audit to you in our Audit Findings Report in July 2020.

6. Other matters

Other work

In addition to our responsibilities under the Code of Practice, we have a number of other audit responsibilities, as follows:

- We read your Narrative Report and Annual Governance Statement and any other information published alongside your financial statements to check that they are consistent with the financial statements on which we give an opinion and consistent with our knowledge of the Authority
- We carry out work to satisfy ourselves that disclosures made in your Annual Governance Statement are in line with the guidance issued by CIPFA
- We carry out work on your consolidation schedules for the Whole of Government Accounts process in accordance with NAO group audit instructions
- We consider our other duties under the Local Audit and Accountability Act 2014 (the Act) and the Code, as and when required, including:
  - Giving electors the opportunity to raise questions about your 2019/20 financial statements, consider and decide upon any objections received in relation to the 2019/20 financial statements
  - Issue of a report in the public interest or written recommendations to the Authority under section 24 of the Act, copied to the Secretary of State
  - Application to the court for a declaration that an item of account is contrary to law under Section 28 or for a judicial review under Section 31 of the Act or
  - Issuing an advisory notice under Section 29 of the Act.
- We certify completion of our audit.

Other material balances and transactions

Under International Standards on Auditing, "irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure". All other material balances and transaction streams will therefore be audited. However, the procedures will not be as extensive as the procedures adopted for the risks identified in this report.

Going concern

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 group, Authority’s and Fund’s ability to continue as a going concern” (ISA (UK) 570). We will review management's assessment of the going concern assumption and material uncertainties, and evaluate the disclosures in the financial statements.

7. Materiality

The concept of 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. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Materiality for planning purposes

Group and Council

We have determined financial statement materiality based on a proportion of the gross expenditure of the Group and Council for the financial year. In the prior year we used the same benchmark. Materiality at the planning stage of our audit is £7.2m (PY £9.3m) for the Council and Group £7.6m (£9.6m). which equates to 1.5% of your prior year gross expenditure for the year. The reduction in materiality compared to the previous year reflects the higher profile of local audit following external reviews such as those led by Sir John Kingman and Sir Tony Redman.

Pension Fund

For the Fund, we have determined financial statement materiality based on a proportion of the Fund's net assets. In the prior year we used the same benchmark. Our materiality at the planning stage is £6.6m (PY £6.4m) which equates to 1% of the Fund's actual net assets for the year ended 31 March 2019.

We reconsider planning materiality if, during the course of our audit engagement, we become aware of facts and circumstances that would have caused us to make a different determination of planning materiality.

Matters we will report to the Audit and Governance Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work. Under ISA 260 (UK) 'Communication with those charged with governance', we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK) defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria. In the context of Council and the Group, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £400k (PY £464k). In the context of the Fund, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £322k (PY £321k).

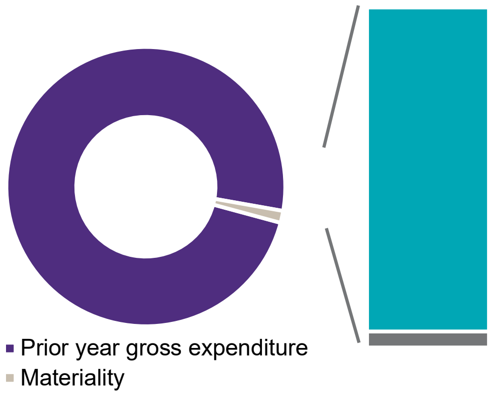
If management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit and Governance Committee to assist it in fulfilling its governance responsibilities.

Prior year gross expenditure

£505m Group

£477m Council

Materiality



£7.6m

Group financial statements materiality

£7.2m

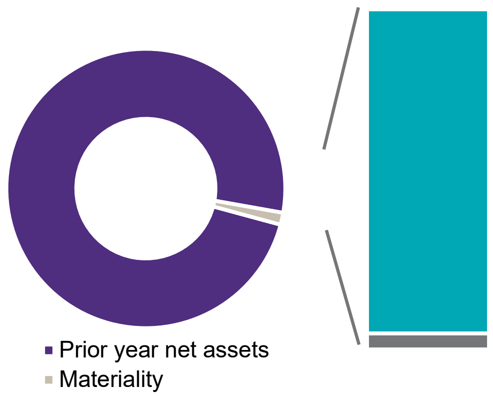
Council's financial statements materiality

(PY: 9.3m)

Pension Fund prior year net assets

£664m

Materiality



£6.6m

Pension Fund financial statements materiality

(PY: 6.4m)

8. Value for Money arrangements

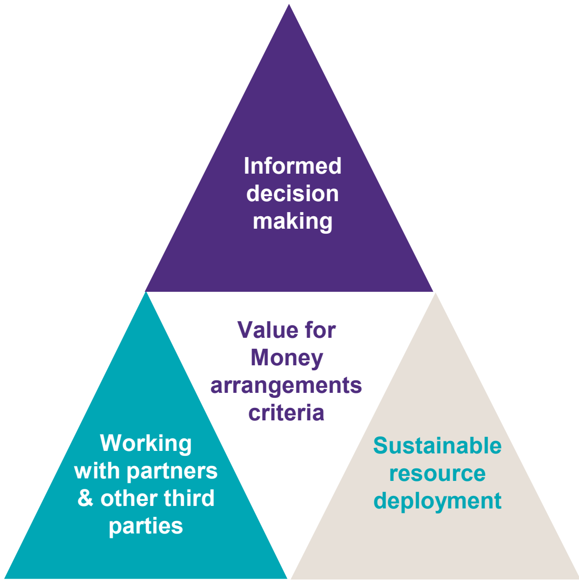
Background to our VFM approach

The NAO issued its guidance for auditors on Value for Money work in November 2017. The guidance states that for Local Government bodies, auditors are required to give a conclusion on whether the Authority has proper arrangements in place to secure value for money.

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:



Significant VFM risks

Those risks requiring audit consideration and procedures to address the likelihood that proper arrangements are not in place at the Authority to deliver value for money.

Budget Management

As at Month 9, you are forecasting a £0.267m underspend on the 2019/20 approved budget. Should the position continue, this will reduce the need to use reserves not planned in the budget.

In response to this risk we will:

- Assess your understanding of, and responses to, the pressures and causal factors contributing to the 2019/20 position.
- Consider whether you have adequate arrangements to manage those pressures and to secure a sustainable financial position.
- Review the council's progress in managing overspends within the Dedicated Schools Grant
- Consider your approach towards the use of reserves.
- Review your progress on the savings plan during the year

Savings and medium-term financial planning

At the time of setting the 2019/20 budget your Medium-Term Financial Strategy showed the Council needed savings of £12.1m in 2020/21, £5.2m in 2021/22 and a further £4.7m in 2022/23 to close the budget gap. This position has been updated and you are now proposing a balanced budget for 2020/21.

In response to this risk we will:

- Consider your revised arrangements to identify and deliver savings and efficiencies to support a sustainable medium-term financial position.
- Consider the feasibility of planned savings and the assessed risk of achievement.
- Review the arrangements for identifying and monitoring risk and taking appropriate action in the event of non-realisation of planned savings.
- Assess how well the medium-term financial plan reflects planned timescales for the delivery of savings from your cross-cutting approach, and how well aligned the medium-term financial plan is with the planned financial benefits anticipated.

Value for Money arrangements Continues

Significant VFM risks

Those risks requiring audit consideration and procedures to address the likelihood that proper arrangements are not in place at the Authority to deliver value for money.

Outcome Based Commissioning

In 2018, the council launched a new Corporate Plan 'Ambitious for Sutton' which set out the priorities for the council under the following themes; Being Active Citizens, Making Informed Choices, Living Well Independently, Keeping People Safe, Smarter Ways of Working. The Outcomes Based Commissioning Plan sets out the activities that the Council will undertake during 2019/20 to deliver these outcomes. The Plan forms part of the performance management framework and progress is monitored through the quarterly Performance and Finance report presented to the Strategy and Resources Committee.

In response to this risk we will:

- Review the activities that the council will has undertaken in 19/20 to deliver the five outcomes.
- Review progress of the Outcomes Based Commissioning Reviews in 2019/20
- Review the progress of the reporting and monitoring of the plan through the Strategy and Resourcing Committee
- Review the Ambitious for Sutton Plan for 2020-22

Agenda Item 12

Page 138

9. Audit logistics & team

Iain Murray, Key Audit Partner

Iain will be the main point of contact for the Chief Executive and Strategic Director of Resources, statutory officers and Members. Iain will share his wealth of knowledge and experience across the sector providing challenge, sharing good practice, providing pragmatic solutions and acting as a sounding board with Senior Management and the Audit and Governance Committee. Iain will ensure our audit is tailored specifically to you and is delivered efficiently. Iain will review all reports and the team's work focussing his time on the key risk areas to your audit.

Keith Mungadzi Audit Manager

Keith will work with the senior members of the finance and executive teams, ensuring early delivery of testing and agreement of accounting issues on a timely basis. Keith will attend Audit and Governance Committee meetings, undertake reviews of the team's work and draft reports, ensuring they remain clear, concise and understandable to all. Keith will work with Internal Audit to secure efficiencies and avoid duplication, providing assurance for your Annual Governance Statement.

Client responsibilities

Where clients do not deliver to the timetable agreed, we need to ensure that this does not impact on audit quality or absorb a disproportionate amount of time, thereby disadvantaging other clients. Where the elapsed time to complete an audit exceeds that agreed due to a client not meeting its obligations we will not be able to maintain a team on site. Similarly, where additional resources are needed to complete the audit due to a client not meeting their obligations we are not able to guarantee the delivery of the audit to the agreed timescales. In addition, delayed audits will incur additional audit fees.

Our requirements

To minimise the risk of a delayed audit, you need to ensure that you:

- produce draft financial statements of good quality by the deadline you have agreed with us, including all notes, the narrative report and the Annual Governance Statement
- ensure that good quality working papers are available at the start of the audit, in accordance with the working paper requirements schedule that we have shared with you
- ensure that the agreed data reports are available to us at the start of the audit and are reconciled to the values in the accounts, in order to facilitate our selection of samples
- ensure that all appropriate staff are available on site throughout (or as otherwise agreed) the planned period of the audit
- respond promptly and adequately to audit queries.

10. Audit fees

Planned audit fees 2019/20

Across all sectors and firms, the FRC has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge and to undertake additional and more robust testing. Within the public sector, where the FRC has recently assumed responsibility for the inspection of local government audit, the regulator requires that all audits achieve a 2A (few improvements needed) rating.

Our work across the sector in 2018/19 has highlighted areas where local government financial reporting, in particular, property, plant and equipment and pensions, needs to be improved. We have also identified an increase in the complexity of local government financial transactions. Combined with the FRC requirement that 100% of audits achieve a 2A rating this means that additional audit work is required. We have set out below the expected impact on our audit fee. The table overleaf provides more details about the areas where we will be undertaking further testing.

As a firm, we are absolutely committed to meeting the expectations of the FRC with regard to audit quality and local government financial reporting. Our proposed work and fee for 2019/20 at the planning stage, as set out below and with further analysis overleaf, has been discussed with the Director of Finance and is subject to PSAA agreement.

	Actual Fee 2017/18	Actual Fee 2018/19	Proposed fee 2019/20
Council Audit	£94,290	£72,603	£97,603
Pension Fund Audit	£21,000	£16,170	£25,000
Sutton Housing Partnership Audit	£33,000	£33,660	34,330
Total audit fees (excluding VAT)	**£148,290**	**£122,433**	**£156,933**

Assumptions:
In setting the above fees, we have assumed that the Authority will:
- prepare a good quality set of accounts, supported by comprehensive and well presented working papers which are ready at the start of the audit
- provide appropriate analysis, support and evidence to support all critical judgements and significant judgements made during the course of preparing the financial statements
- provide early notice of proposed complex or unusual transactions which could have a material impact on the financial statements.

Relevant professional standards:
In preparing our fee estimate, we have had regard to all relevant professional standards, including paragraphs 4.1 and 4.2 of the FRC's Ethical Standard which stipulate that the Engagement Lead (Key Audit Partner) must set a fee sufficient to enable the resourcing of the audit with staff of appropriate skills, time and abilities to deliver an audit to the required professional standard.

Audit fee variations – Further analysis

Planned audit fees

The table below shows the planned variations to the original scale (contracted in the case of non PSAA) fee for 2019/20 based on our best estimate at the audit planning stage. Further issues identified during the course of the audit may incur additional fees. In agreement with PSAA (where applicable) we will be seeking approval to secure these additional fees for the remainder of the contract via a formal rebasing of your scale fee to reflect the increased level of audit work required to enable us to discharge our responsibilities. Should any further issues arise during the course of the audit that necessitate further audit work additional fees will be incurred, subject to PSAA approval.

Audit area	£	Rationale for fee variation
Scale fee	72,603	
Raising the bar and change in Materiality	7,000	The Financial Reporting Council (FRC) has highlighted that the quality of work by all audit firms needs to improve across local audit. This will require additional supervision and leadership, as well as additional challenge and scepticism in areas such as journals, estimates, financial resilience and information provided by the entity. This year we have reduced our materiality (1.5% of your gross expenditure) compared to the previous year reflects the higher profile of local audit following external reviews such as those led by Sir John Kingman and Sir Tony Redman
Pensions – valuation of net pension liabilities under International Auditing Standard (IAS) 19	4,000	The Financial Reporting Council (FRC) has highlighted that the quality of work by all audit firms in respect of IAS 19 needs to improve across local government audits. Accordingly, we plan to increase the level of scope and coverage of our work in respect of IAS 19 this year to reflect the expectations of the FRC and ensure we issue a safe audit opinion. Specifically, we have increased the granularity, depth and scope of coverage, with increased levels of sampling, additional levels of challenge and explanation sought, and heightened levels of documentation and reporting.
PPE Valuation – work of experts	9,000	As above, the FRC has also determined that auditors need to improve the quality of audit challenge on PPE valuations across the sector. Specifically, we have increased the granularity, depth and scope of coverage, with increased levels of sampling, additional levels of challenge and explanation sought, and heightened levels of documentation and reporting.
Group Accounts and New Accounting Standards	5,000	Note that PSAA's original scale fee for this contract was set in March 2018, so any new developments since that time need to be priced in, including the increase in the work to audit your group financial statements as more companies are considered for consolidation and the capture new accounting standards issued.
Revised scale fee (to be approved by PSAA)	**£97,603**	

Page 141

Agenda Item 12

Audit fee variations – Pension Fund

Planned audit fees

The table below shows the planned variations to the original scale fee for 2019/20 based on our best estimate at the audit planning stage. Further issues identified during the course of the audit may incur additional fees.

Audit area	£	Rationale for fee variation
Scale fee	16,170	This is the PSAA scale fee and is unchanged from 2018/19.
Raising the bar	5,000	The Financial Reporting Council (FRC) has highlighted that the quality of work by all audit firms needs to improve across local audit. This will require additional supervision and leadership, as well as additional challenge and scepticism in areas such as journals, estimates, financial resilience and information provided by the entity.
Valuation of investments	3,830	The Financial Reporting Council (FRC) has highlighted that the quality of work by all audit firms in respect of valuations of investments needs to improve across the sector. Accordingly, we plan to enhance the scope and coverage of our work to ensure an adequate level of audit scrutiny and challenge over the assumptions and evidence that underpin the valuations of level 2 and level 3 investments this year to reflect the expectations of the FRC and ensure we issue a safe audit opinion.
Revised scale fee (to be approved by PSAA)	£25,000	This is subject to no direct property investments being made prior to 31 March 2020.

11. Independence & non-audit services

Auditor independence

Ethical Standards and ISA (UK) 260 require us to give you timely disclosure of all significant facts and matters that may bear upon the integrity, objectivity and independence of the firm or covered persons relating to our independence. In this context, we report the following to you:

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 and PSAA's Terms of Appointment which set out supplementary guidance on ethical requirements for auditors of local public bodies.

11. Independence & non-audit services continued

Other services provided by Grant Thornton

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

Service	£	Threats	Safeguards
Audit related:			
Certification of Housing capital receipts grant	5,000	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work of £5,000 in comparison to the total fee for the audit of £97,603 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors mitigate the perceived self-interest threat to an acceptable level.
Certification of Teachers' Pension return	5,000	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work of £5,000 in comparison to the total fee for the audit of £97,603 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors mitigate the perceived self-interest threat to an acceptable level.
Certification of Housing Benefits claim	**tbc**	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work in 2018/19 was £12,300 in comparison to the total fee for the audit of £97,603 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors mitigate the perceived self-interest threat to an acceptable level.
Non-audit related:			
None			

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 your policy on the allotment of non-audit work to your auditors. All services have been approved by the Audit and Governance Committee. Any changes and full details of all fees charged for audit related and non-audit related services by Grant Thornton UK LLP and by Grant Thornton International Limited network member Firms will be included in our Audit Findings report at the conclusion of the audit.
None of the services provided are subject to contingent fees. The firm is committed to improving our audit quality – please see our transparency report - https://www.grantthornton.ie/about/transparency-report/

Appendices

Appendix A: Audit Quality – national context

What has the FRC said about Audit Quality?

The Financial Reporting Council (FRC) publishes an annual Quality Inspection of our firm, alongside our competitors. The Annual Quality Review (AQR) monitors the quality of UK Public Interest Entity audits to promote continuous improvement in audit quality.

All of the major audit firms are subject to an annual review process in which the FRC inspects a small sample of audits performed from each of the firms to see if they fully conform to required standards.

The most recent report, published in July 2019, shows that the results of commercial audits taken across all the firms have worsened this year. The FRC has identified the need for auditors to:

- improve the extent and rigour of challenge of management in areas of judgement
- improve the consistency of audit teams' application of professional scepticism
- strengthen the effectiveness of the audit of revenue
- improve the audit of going concern
- improve the audit of the completeness and evaluation of prior year adjustments.

The FRC has also set all firms the target of achieving a grading of '2a' (limited improvements required) or better on all FTSE 350 audits. We have set ourselves the same target for public sector audits from 2019/20.

Other sector wide reviews

Alongside the FRC, other key stakeholders including the Department for Business, energy and Industrial Strategy (BEIS) have expressed concern about the quality of audit work and the need for improvement. A number of key reviews into the profession have been undertaken or are in progress. These include the review by Sir John Kingman of the Financial Reporting Council (Dec 2018), the review by the Competition and Markets authority of competition within the audit market, the ongoing review by Sir Donald Brydon of external audit, and specifically for public services, the Review by Sir Tony Redmond of local authority financial reporting and external audit. As a firm, we are contributing to all these reviews and keen to be at the forefront of developments and improvements in public audit.

What are we doing to address FRC findings?

In response to the FRC's findings, the firm is responding vigorously and with purpose. As part of our Audit Investment Programme (AIP), we are establishing a new Quality Board, commissioning an independent review of our audit function, and strengthening our senior leadership at the highest levels of the firm, for example through the appointment of Fiona Baldwin as Head of Audit. We are confident these investments will make a real difference.

We have also undertaken a root cause analysis and put in place processes to address the issues raised by the FRC. We have already implemented new training material that will reinforce the need for our engagement teams to challenge management and demonstrate how they have applied professional scepticism as part of the audit. Further guidance on auditing areas such as revenue has also been disseminated to all audit teams and we will continue to evolve our training and review processes on an ongoing basis.

What will be different in this audit?

We will continue working collaboratively with you to deliver the audit to the agreed timetable whilst improving our audit quality. In achieving this you may see, for example, an increased expectation for management to develop properly articulated papers for any new accounting standard, or unusual or complex transactions. In addition, you should expect engagement teams to exercise even greater challenge management in areas that are complex, significant or highly judgmental which may be the case for accounting estimates, going concern, related parties and similar areas. As a result you may find the audit process even more challenging than previous audits. These changes will give the audit committee – which has overall responsibility for governance - and senior management greater confidence that we have delivered a high quality audit and that the financial statements are not materially misstated. Even greater challenge of management will also enable us to provide greater insights into the quality of your finance function and internal control environment and provide those charged with governance confidence that a material misstatement due to fraud will have been detected.

We will still plan for a smooth audit and ensure this is completed to the timetable agreed. However, there may be instances where we may require additional time for both the audit work to be completed to the standard required and to ensure management have appropriate time to consider any matters raised. This may require us to agree with you a delay in signing the announcement and financial statements. To minimise this risk, we will keep you informed of progress and risks to the timetable as the audit progresses.

We are absolutely committed to delivering audit of the highest quality and we should be happy to provide further detail about our improvement plans should you require it.

grantthornton.co.uk

This page is intentionally left blank