# LONDON BOROUGH OF ENFIELD AND PENSION FUND

Annual Audit Letter

Year ended 31 March 2019

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# EXECUTIVE SUMMARY

## Purpose of the Annual Audit Letter

This Annual Audit Letter summarises the key issues arising from the work that we have carried out in respect of the year ended 31 March 2019.

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:

- Our opinion on the Council's and Pension Fund's financial statements; and
- 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**

9 January 2020

## Audit conclusions

| Audit area | Conclusion |
|---|---|
| Financial statements - Council | Unmodified opinion |
| Financial statements - Pension Fund | Unmodified opinion |
| Use of resources | Unmodified conclusion |
| Audit certificate | We are unable to issue our audit certificate until we have completed our review of the Whole of Government Accounts return and issued our opinion on the consistency of the return with the audited financial statements. Work is ongoing in relation to objections received, although we are satisfied from our review to date that this does not have a material effect on the financial statement or on our value for money conclusion. |

We issued our audit opinion on the Council's and Pension Fund's financial statements and use of resources conclusion on 19 December 2019, which was after the national deadline of 31 July 2019 due to misstatements, including six material misstatements, identified during the audit and needing to resolve issues with non-current asset valuations identified through challenge of external valuations.

# FINANCIAL STATEMENTS

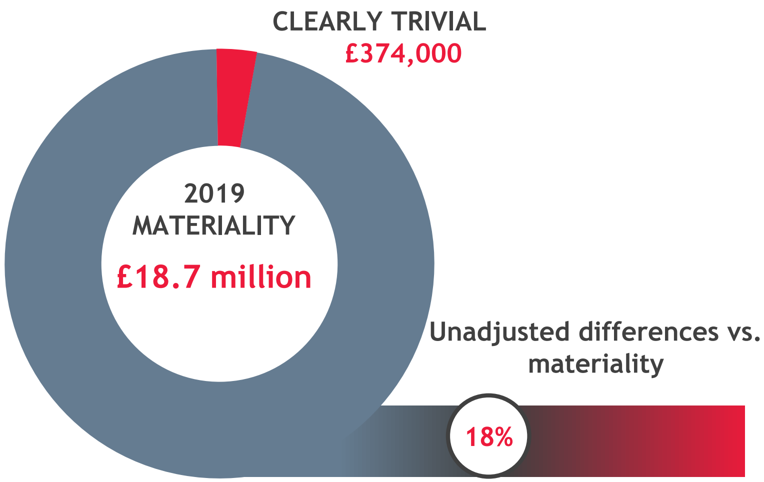
## Audit opinion on the financial statements

We issued an unmodified audit opinion on the financial statements. This means that we consider that the financial statements:

- Give a true and fair view of the financial position and its income and expenditure for the year; and
- Have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting 2018/19.

## Final materiality

Materiality for the Council's financial statements as a whole was calculated at £18.7 million based on a benchmark of 1.75% of gross expenditure.




## Material misstatements

We identified six material misstatements:

- £113.4 million overstatement of both income and expenditure in the total costs of services (£33.8 million prior period adjustment).
- Reclassification of £34.6 million surplus assets to operational council dwellings (£27.2 million) and assets under construction (£7.4 million).
- £39.5 million reclassification for the Meridian Water train station from assets under construction to REFCUS expenditure (£22.0 million in the current year and £17.5 million in prior years).
- £27.5 million reclassification for the revaluation gains on assets disposed of during the year incorrectly recognised with loss on disposals.
- £37.0 million for the increase in defined benefit pension liability for the impact of the McCloud judgement and GMP indexation.
- £21.5 million reclassification of asset under construction additions to council dwellings relating to the buy back of former dwellings. An impairment charge of £16.1 million was charged to the CIES following the change is classification and therefore asset valuation methodology.
- Management amended the financial statements for these issues, along with other adjustments which has increased the deficit on the provision of services by £108.8 million.

## Unadjusted audit differences

We identified audit adjustments that, if posted, would decrease the net deficit on provision of services for the year by £3.4 million.

# AUDIT RISKS OVERVIEW

As identified in our Audit Planning Report presented to the Audit and Risk Management Committee in January 2019 we assessed the following matters as being the risks of material misstatement in the financial statements. Those rated as significant had the greatest effect on: the overall audit strategy; the allocation of resources in the audit and the direction of the efforts of the engagement team.

| Audit Risk | Risk Rating | Significant Management Judgement Involved | Error Identified | Control Findings to be reported |
|---|---|---|---|---|
| Management override of controls (*Council and pension fund)* | Significant | Yes | No | Yes |
| Non-current asset valuations *(Council only)* | Significant | Yes | Yes, unadjusted and adjusted | Yes |
| Pension liability assumptions (*Council and pension fund)* | Significant | Yes | No | No |
| Implementation of IFRS 9 *(Council only)* | Significant | Yes | Yes, adjusted | No |
| Implementation of IFRS 15 (*Council only)* | Significant | Yes | No | No |
| Valuation of infrastructure assets (*pension fund only)* | Significant | Yes | Yes, adjusted | No |
| Relation party transactions (*Council and pension fund)* | Normal | No | Yes, adjusted | No |
| Revenue recognition (*Council only)* | Normal | No | Yes, adjusted | No |
| Membership disclosure *(Pension fund only)* | Normal | No | No | No |

# 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.

| Risk description | How the risk was addressed by our audit | Results |
|---|---|---|
| Management override of controls | We carried out the following planned audit procedures:<br>• Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements;<br>• Reviewing accounting estimates for biases and evaluated whether the circumstances producing the bias, if any, represented a risk of material misstatement due to fraud; and<br>• Obtaining an understanding of the business rationale for significant transactions that were outside the normal course of business for the Council or that otherwise appeared to be unusual, if any. | We found that there were a number of journals posted by employees who had left the organisation, and were posted after they had left. We performed additional testing on these journals and did not identify any indication of management override.<br>We did not identify any transactions outside the normal course of business.<br>Our audit work has not identified any other significant issues on areas we considered to be a specific risk of management override. |

# FINANCIAL STATEMENTS

| Risk description | How the risk was addressed by our audit | Results |
|---|---|---|
| Non-current asset valuations | We carried out the following planned audit procedures:<br>• Reviewed the instructions provided to the valuer and the consider valuer's skills and expertise in order to determine if we can rely on the management expert.<br>• Checked whether the basis of valuation for assets valued in year is appropriate; in particular, whether an instant build modern equivalent asset basis has been used for assets valued at depreciated replacement cost and that investment properties and surplus assets have been valued at 'highest and best use'.<br>• Reviewed the reasonableness of assumptions used in the valuation of non-current assets, the accuracy and completeness of the source data used by the valuer and the Council's critical assessment of the external valuer's conclusions.<br>• Followed up valuation movements that appear unusual against indices, or any assets which have not been revalued at the year-end which may have had material movements since the last formal valuation.<br>• Reviewed the classification of Meridian Water assets within the financial statements and confirm that this is consistent with the basis for valuation. | ***Reconciliation of valuation reports to ledger***<br>We identified one error within other land and buildings, whereby the movement in asset values for general fund dwellings had been included in other land and buildings as well as Council Dwellings. The adjustment to reverse this double-counting is to reduce both other land and buildings and revaluation reserve by £1.4 million.<br>***Council's challenge to valuers***<br>The level of challenge by management was not sufficiently robust for us to place any reliance on the control. We had to substantially increase our sample sizes and raised this as a significant control deficiency.<br>***Council dwellings***<br>The Council has prepared working papers to adjust the values of council dwellings not valued directly or by direct extrapolation by reference to those that have been. The purpose of this exercise was both to reflect potential understatement of the position as at 31 March 2019 but also potential understatement of the position as at 31 March 2018, this latter highlighted by higher than expected increases in valuation during the year. The increase in value as at 31 March 2019 calculated was £14.4 million. The exercise also identified three typo errors in the beacon valuation matrix. These combined to further increase the valuation as at 31 March 2019 by £3.6 million. The impact upon prior period valuations was to increase valuations by £26.3 million. This change in opening position, in combination with the 2 preceding items, resulted in a net negative revaluation movement during the period of £7.7 million. The Council has adjusted for all of these items. |

# FINANCIAL STATEMENTS

| Risk description | How the risk was addressed by our audit | Results |
|---|---|---|
| Non-current asset valuations (continued) | | ***Other land and buildings***<br>We identified differences between the floor plans and the information provided to the valuer to calculate the year-end asset valuations. We then compared the BCIS (build cost information services) indices used by the valuer as at 1 March to the updated BCIS indices as at 31 March 2019 based on more up to date information available at the time of audit and identified further discrepancies. The total understatement was £4.3 million, and extrapolated across the untested balance for schools, gave a total understatement of £7.1 million. Our testing on non-schools land and buildings identified further variances of £0.3 million for updated BCIS indices, which we extrapolated to £0.8 million. The Council has adjusted for the total of £7.9 million.<br>***Surplus assets***<br>As at 31 March 2019, no development construction had started on the land and the Council had not concluded on the definitive plans for the first phase of the scheme, which is no change from our assessment in the prior year. We have ultimately concluded that we are satisfied with the classification of surplus assets.<br>***Investment properties***<br>For the sample of investment properties reviewed, we were satisfied that the basis of the valuation for each asset is appropriate and that the revaluation movements have been correctly accounted for.<br>***Assets not revalued during the year***<br>For surplus assets, a balance of £6.5 million had not been revalued during the year, which is not in line with the accounting standard treatment. £4.7 million relates to land at Electric Quarter which was due to be transferred to the developer prior to the year-end. However, the land transfer did not happen before the year-end and so the assets are in the financial statements at the fair value calculated as at 31 March 2018. As the Council are in the process of negotiating the land transfer as nil cost to the development, the value should have been impairment down to £nil in the financial statements. This is adjusted in the revised financial statements. |

# FINANCIAL STATEMENTS

| Risk description | How the risk was addressed by our audit | Results |
| --- | --- | --- |
| Pension liability assumptions | We carried out the following planned audit procedures:<br>• Agreed the disclosures to the information provided by the pension fund actuary<br>• Reviewed the reasonableness of the assumptions used in the calculation against other local government actuaries and other observable data<br>• Checked whether any significant changes in membership data have been communicated to the actuary. | The Council obtained a further revised IAS 19 report in July 2019, to allow for the impact on liabilities at 31 March 2019 due to the McCloud Judgement and GMP equalisation. The additional liability calculated is £33.3 million in respect of the McCloud judgement and £3.6 million in respect of GMP indexation and were posted to the revised financial statements.<br>All of the assumptions used fall within the reasonable range for the actuary as per the PwC report, however all assumptions with the exception of the discount rate are at the top end of the range for Aon Hewitt. We note that the consulting actuary has stated that the assumptions used by Aon Hewitt do tend to produce slightly lower liability calculations that then other actuaries, and the relative liability compared to assumptions used by others could result in a liability being at 98.3% using an average of all the actuaries.<br>The accounting entries and disclosures are in line with our expectation and the Code. |

# FINANCIAL STATEMENTS

| Risk description | How the risk was addressed by our audit | Results |
| --- | --- | --- |
| Implementation of IFRS 9 (financial instruments) | We carried out the following planned audit procedures:<br>• Reviewed the draft financial statements and supporting working papers which details the Council's proposed approach to the new accounting standard.<br>• Checked the draft financial statements against the CIPFA Disclosure Checklist to ensure that all of the required presentational changes have been correctly reflected within the financial statements. | Management classified all their assets and liabilities at amortised cost with the exception of the loan with Lea Valley Heat Network Ltd (LVHN) which is classified at fair value through profit or loss (FVPL), for which they obtained an external valuation. We are satisfied with the classifications of financial instruments in the financial statements.<br>We identified that the loan to LVHN was recognised at amortised cost in the prior year, with a classification to FVPL in 2018/19. This loan should have been recognised as FVPL in the prior year, and is corrected in the revised financial statements.<br>The total movement in valuation of £2.5 million was recognised in the current year, however only the movement during the year should be recognised as an expense in 2018/19. Subsequent to our audit testing, the Council obtained a valuation for the opening balance which indicates an impairment of £1.5 million during the year. The Council has therefore made an adjustment of £1.0 million in the revised financial statements.<br>Management have not made any changes to expected credit losses on any other financial instruments assets as these are immaterial. We reported an unadjusted classification adjustment of £0.6 million. |

# FINANCIAL STATEMENTS

| Risk description | How the risk was addressed by our audit | Results |
|---|---|---|
| Implementation of IFRS 15 (revenue recognition) | We carried out the following planned audit procedures:<br>• Reviewed the draft financial statements and supporting working papers which details the proposed approach to the new accounting standard by both the Council and the group.<br>• Checked the draft financial statements against the CIPFA Disclosure Checklist to ensure that all of the required presentational changes have been correctly reflected within the financial statements. | No issues were identified by our audit of the implementation of IFRS 15. |

# FINANCIAL STATEMENTS (PENSION FUND ONLY)

| Risk description | How the risk was addressed by our audit | Results |
|---|---|---|
| Valuation of investment assets (infrastructure and private equity) | We carried out the following planned audit procedures:<br>• Obtained direct confirmation of investment valuations from the General Partner or fund manager and have requested copies of the audited financial statements of the underlying partnerships (and member allocations).<br>• Where the financial statement date supporting the valuation is not conterminous with the pension fund's year end, we have confirmed that appropriate adjustments have been made to the valuations in respect of additional contributions and distributions with the funds.<br>• We have ensured investments have been correctly valued in accordance with the relevant accounting policies. | We found that from discussions with officers we identified that a journal was required to Increase the value of investments by £4,621,192.<br>This increase relates to Antin and Adam Street Partners investments, which have been included in the draft accounts based on the figures as at 31 December 2018 as the valuations as at 31 March 2019 were not available when the drafts were finalised.<br>This was corrected for in the revised financial statements. |

# USE OF RESOURCES

## Audit conclusion on use of resources

We issued an unmodified conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources. This means that we consider that in all significant respects, the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We set out below the risks that had the greatest effect on our audit strategy.

| Risk description | How the risk was addressed by our audit | Results |
|---|---|---|
| Sustainable finances | We carried out the following planned audit procedures:<br>• We reviewed the assumptions used in the Medium Term Financial Strategy and assess the reasonableness of the cost pressures and the amount of Government grant reductions applied.<br>• We reviewed the delivery of the budgeted savings in 2018/19 and the plans to reduce services costs and increase income from 2018/19.<br>• We also reviewed the strategies to close the budget gap in the medium term. | The Council budgeted to spend £227.9 million on General Fund services in 2018/19 (incorporating a savings target of £8.6 million). The actual cost of services (before technical accounting adjustments) in 2018/19 was £232.3 million, overspends of £13.4 million against service budgets, which was partially offset by favourable variances in corporate budgets. There was a drawdown on reserves of £3.2 million to balance outturn.<br>The Council has a savings efficiency plan of £8.6 million, however it does not directly monitor performance against this target, instead it monitors overall performance through quarterly reporting. The Council set a balanced budget for 2019/20 which includes £13.1 million of new savings and income generations across all the executive directorates. Funding gaps have been identified from 2020/21 to 2024/25 (£14.0 million, £5.6 million, £5.9 million, £6.9 million and £6.5 million respectively). These gaps will increase if required savings in 2019/20 are not met.<br>Overall, the Council needs to continue to address and monitor the control of costs incurred in the demand-led services, the delivery of the savings necessary to meet the MTFS and the impact of the changes being implemented on the delivery of services, to ensure that there are no unanticipated detrimental outcomes. Although the challenges are significant, the Council understands them and is working to identify solutions. There is therefore no impact on our use of resources conclusion. |

# USE OF RESOURCES

| Risk description | How the risk was addressed by our audit | Results |
|---|---|---|
| Meridian Water and other regeneration projects | We reviewed the programme and project management arrangements instigated by management to govern the delivery of the regeneration projects and ensure that the anticipated benefits are realised. | The Council faces a number of challenges that need to be addressed so that the projects can proceed in the manner envisaged, and it is working hard to overcome these challenges and progress the delivery of the projects. We will continue to monitor this progress.<br>We are satisfied that there is no impact on our use of resources conclusion. |

# REPORTS ISSUED AND FEES

## Fees summary

| | 2018/19 Final £ | 2018/19 Planned £ | 2017/18 Final £ | 2016/17 Final £ |
|---|---|---|---|---|
| Audit fee – PSAA scale fee | | | | |
| • Council | 132,104* | 132,104 | 171,564 | 187,564 |
| • Pension Fund | 18,857 | 18,857 | 24,489 | 24,489 |
| • Objections | - | N/A | - | 8,799 |
| Non-audit assurance services: | | | | |
| Fees for reporting on government grants: | | | | |
| • Housing benefits subsidy claim | - | - | 40,850 | 30,533 |
| • Pooling of housing capital receipts return | - | - | 5,000 | 5,000 |
| • Teachers' pensions return | - | - | 3,500 | - |
| • GLA scheme | - | - | - | 3,000 |
| Fees for other non-audit services | - | - | 49,350 | 38,533 |
| **Total fees** | 150,961 | 150,961 | 220,914 | 259,385 |

## Communication

| Reports | Date | To whom |
|---|---|---|
| Grant claims and returns certification - 2017/18 | March 2019 | Audit and Risk Management Committee (ARAC) |
| Audit plan - Council | January 2019 | ARAC |
| Audit plan - Pension Fund | January 2019 | ARAC |
| Audit completion report - Council | July 2019 | ARAC |
| Audit completion report - Pension Fund | July 2019 | ARAC |

*Additional fee for overruns for 2018/19 still to be agreed with management and the PSAA.

2016/17 outturn fees included:

- £16,000 relating to Council audit overruns agreed
- £8,799 on account for objections work undertaken in respect of the 2015/16 objections received

FOR MORE INFORMATION:

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