

A photograph of four business professionals (three men and one woman) sitting around a glass conference table in a modern office. They are all dressed in business attire (shirts and ties). The man on the left, with grey hair, is gesturing with his hands while speaking. The other three are listening attentively. On the table, there are several white coffee cups on saucers, a laptop, and some papers. Large windows in the background show a cityscape.

CITY OF LONDON CORPORATION - CITY FUND AND PENSION FUND

ANNUAL AUDIT LETTER

Audit for the year ended 31 March 2017

19 October 2017



EXECUTIVE SUMMARY

PURPOSE OF THE 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 2017. It is addressed to the Corporation but is also intended to communicate the key findings we have identified to key external stakeholders and members of the public. It will be published on the website of Public Sector Audit Appointments Limited.

RESPONSIBILITIES OF AUDITORS AND THE CORPORATION

It is the responsibility of the Corporation 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), and to review and report on:

- The City Fund and pension fund financial statements
- Whether the Corporation has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources in respect of the City Fund.

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
19 October 2017

AUDIT CONCLUSIONS

FINANCIAL STATEMENTS

We issued our unmodified true and fair opinions on the City Fund and pension fund financial statements on 29 September 2017.

We reported our findings to the Audit and Risk Management Committee on 24 July and 10 October. We did not identify any material misstatements.

Audit differences corrected by management in the City Fund financial statements reduced the deficit on the provision of services and increased net assets by £2.5 million. This was mainly due to releasing deferred income to revenue and transferring balances to earmarked reserves. In addition we found two audit differences not corrected in the final financial statements which would, if corrected, reduce the deficit on the provision of services by £164,000.

USE OF RESOURCES

We issued our unmodified conclusion on the City Fund's arrangements for securing economy, efficiency and effectiveness in its use of resources on 29 September 2017.

There are healthy levels of reserves available to support City Fund's services in the medium term and we are satisfied that there are appropriate arrangements in place to continue to remain financially sustainable over the period of the Medium Term Financial Strategy.

The Corporation is in a position to fund a significant proportion of the City Police forecast deficits. However, it is recognised that this is not sustainable over the longer term and City Police plan to address the recommendations from the external value for money review to improve the operating model and deliver service and financial savings to reduce the budget gap.

FINANCIAL STATEMENTS

OPINION

We issued our unmodified true and fair opinions on the City Fund and pension fund's financial statements on 29 September 2017.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

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 City Fund 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 ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

Our audit was scoped by obtaining an understanding of the Corporation, in relation to the City Fund 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.

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	CONCLUSION
There is a risk that revenue or capital grants that are subject to performance conditions may be inappropriately recognised as revenue before the condition have been met, revenue may not exist or be recognised in the wrong financial year.	<p>We tested an increased sample of revenue and capital grants subject to performance conditions and confirmed that these were only recognised as revenue when the relevant conditions of the funding had been met.</p> <p>We tested an increased sample of grants held as deferred income and found that £0.5 million of new homes bonus grant relating to 2017/18 had been classified as a debtor and receipt in advance. As the grant relates to 2017/18 and the cash had not been received by 31 March 2017 the grant should not have been recorded in the financial statements.</p> <p>We also found that £1 million of Community Infrastructure Levy income due and received in 2016/17 had been accounted for as a receipt in advance rather than income. Management corrected these errors in the financial statements.</p> <p>We tested an increased sample of fees and charges income throughout the year and confirmed that the amounts recorded agreed to underlying documentation for charges or services provided and that the revenue had been recorded in the correct period.</p>	We concluded that revenue had been recorded correctly following the corrections to the financial statements.

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	CONCLUSION
<p>Local authorities are required to ensure that land, buildings and investment properties are regularly revalued.</p> <p>Management use external valuation data to assess whether there has been a material change in the value of classes of assets. Investment properties are revalued annually according to market conditions at year-end. Higher value operational properties (other land and buildings and dwellings) are revalued annually to provide assurance that carrying values are materially stated, with the remainder of non-material value assets revalued periodically (minimum of every five years).</p> <p>We consider there to be a risk over the reasonableness of the valuations due to the estimation and judgments applied.</p>	<p>We responded to this risk by reviewing the instructions provided to the valuer to confirm that the planned scope of the valuation was appropriate. We reviewed the valuer's skills and expertise and were satisfied that we could rely on this work.</p> <p>We checked whether accurate and complete data on assets held was provided to undertake the review and that the basis of valuation for assets was appropriate.</p> <p>We reviewed valuation movements against indices of price movements for similar classes of assets and challenged valuations where the movement appeared unusual.</p> <p>Property, plant and equipment valuations increased by £14.2 million with the majority being attributable to increases in values for dwellings.</p> <p>Investment properties increased by £54.9 million mainly arising from a general increase in the market (using the IPD capital index for City office space). There were several outliers where the market value had significantly increased/decreased and this was found to relate to changes in rental amounts and change in property use.</p>	<p>We concluded that the valuations for land, buildings and investment properties were reasonable.</p>

FINANCIAL STATEMENTS

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	CONCLUSION
<p>An estimate of the Corporation's pension fund liabilities (LGPS and police) and the share allocated to the City Fund is calculated by an actuary with specialist knowledge and experience.</p> <p>The estimate is based on the membership data used by the actuary for the 2016 triennial valuation and updated for local factors such as mortality rates and expected pay rises along with other assumptions around inflation when calculating the liability.</p> <p>We considered there to be a risk that the valuation was not based on accurate membership data or used inappropriate assumptions to value the liability.</p>	<p>We received and reviewed a report from a consulting actuary, commissioned by the National Audit Office, that confirmed that the actuary was independent of the Corporation and suitably experienced and qualified.</p> <p>We reviewed the accuracy of the data recorded in the membership records and the information provided to the actuary. We checked and confirmed that there had been no significant changes in employee numbers to be communicated to the actuary that could require amendment to the 2016 roll-forward data.</p> <p>We reviewed the reasonableness of the assumptions used by the actuary against other local government actuaries and other observable data. This found that the actuary had applied a higher than expected percentage for future increases in RPI, salaries and pensions (increasing the liability) but also a higher discount rate to assess the present value of these liabilities (lowers the liability). In response, we commissioned a separate review from an independent actuary to review the strength of the assumptions applied and the potential overall impact on the calculation. This concluded that the assumptions in aggregate result in a pension liability estimate that is reasonable.</p>	<p>We concluded that the actuarial valuation of the Corporation's pension fund liability and the share allocated to the City Fund was reasonable.</p>

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.

Importantly, misstatements below these levels will not necessarily be evaluated as immaterial as we also take account of the nature of identified misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements as a whole.

The materiality for the City Fund's financial statements as a whole was set at £23 million based on property, plant and equipment and investment properties (of which it represents 1.0 per cent). This is because the City Fund has custody of significant public assets through its ownership of property assets and investments that are used to generate income to support the local authority services provided by the City Fund. We applied a specific lower materiality of £5.8 million on revenue resources based on a benchmark of gross expenditure (of which it represents 1.5 per cent).

The materiality for the pension fund's financial statements as a whole was set at £9.6 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 the financial performance.

We agreed with the Audit and Risk Management Committee that we would report all individual audit differences in excess of £460,000 for the City Fund and £193,000 for the pension fund.

AUDIT DIFFERENCES - CITY FUND

We did not identify any material misstatements. Audit differences corrected by management reduced the deficit on the provision of services and increased net assets by £2.5 million. This was mainly due to releasing deferred income to revenue and transferring balances to earmarked reserves.

In addition we found two audit differences not corrected in the final financial statements which would, if corrected, reduce the deficit on the provision of services by £164,000.

We consider that these uncorrected misstatements did not have a material impact on our opinion on the City Fund's financial statements.

AUDIT DIFFERENCES - PENSION FUND

We did not identify any material misstatements impacting on the Fund Account or Net Assets Statement.

FINANCIAL STATEMENTS

OTHER MATTERS WE REPORT ON

Narrative report

We are satisfied that the narrative report meets the new requirements of the CIPFA Code and that financial information is consistent with the financial statements.

Annual governance statement

We concluded that the annual governance statement was not misleading or inconsistent with other information we were aware of from our audit, the evidence provided in the City Fund's review of effectiveness of controls and our knowledge of the Corporation.

INTERNAL CONTROLS

We did not find any significant deficiencies in internal controls during the course of our audit. A number of other areas for improvement were identified which we have discussed with management.

WHOLE OF GOVERNMENT ACCOUNTS

Auditors are required to review Whole of Government Account (WGA) information prepared by component bodies that are over the prescribed threshold of £350 million in any of: assets (excluding certain non-current assets); liabilities (excluding pension liabilities); income or expenditure.

Our review was undertaken in accordance with the Group Audit Instructions issued by the National Audit Office. This requires that we compare the information in your Data Collection Tool (DCT) submission with the audited financial statements, undertake testing of completeness and accuracy of WGA counter party transactions and balances, and provide an assurance statement to the National Audit Office.

This work is in progress.

USE OF RESOURCES

CONCLUSION

We issued our unmodified conclusion on the City Fund's arrangements for securing economy, efficiency and effectiveness in its use of resources on 29 September 2017.

SCOPE OF THE AUDIT OF USE OF RESOURCES

We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources based on the following reporting criterion:

In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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 Corporation including internal audit, information disclosed or available to support the governance statement and annual report, 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 direction of the efforts of the audit team.

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	CONCLUSION
<p>The Medium Term Financial Strategy for City Police has forecast significant deficits in coming years and it is expected that the police ring-fenced reserves will be fully utilised by 31 March 2018.</p> <p>Identifying the required level of savings in the medium term will be a challenge and is likely to require review of existing services.</p>	<p>We reviewed the financial outturn of City Police, the medium term financial and strategic plans and the findings of the external value for money review.</p> <p>The 2016/17 outturn was breakeven which is an improvement on the forecast overspend of £2.6 million. Net expenditure in 2017/18 is forecast to increase by £5.7 million with additional costs coming from the Action Fraud Service I.T project, additional employer pension contributions to tackle the pension deficit as well as a reduction in the core police settlement grant.</p> <p>In order to balance the budget to 31 March 2018, City Fund will provide additional resources to fund specific costs and the remaining will be met by police reserves. The MTFS to 2019/20 forecasts deficits of £5.6 million in 2018/19 and £3.8 million in 2019/20.</p> <p>The value for money review was commissioned to develop efficiency strategies to address the budget gap and financial pressures. The review focused on current and future demand and how efficiently City Police used its total resources.</p> <p>Recommendations have been made to enhance the operating model and deliver value for money which could deliver recurring savings to eliminate the budget gap identified in the MTFS. Management is working through an action plan to deliver these savings.</p>	<p>The Corporation is in a position to fund a significant proportion of forecast police deficits.</p> <p>However, it is recognised that this is not sustainable over the longer term and City Police plan to address the recommendations from the external value for money review to improve the operating model and deliver service and financial savings to reduce the budget gap.</p>

USE OF RESOURCES

RISK DESCRIPTION	HOW RISK WAS ADDRESSED BY OUR AUDIT AND AUDIT FINDINGS	CONCLUSION
<p>The City Fund MTFS requires significant savings and income generation in the medium term. If key assumptions and savings plans have not been based on reliable data or have been overly optimistic the financial position could deteriorate over the medium term.</p>	<p>We have reviewed the financial outturn for the City Fund to date and the assumptions in the MTFS. The 2016/17 financial outturn outperformed budget by £9.3 million after taking into account a £27 million purchase of an investment property funded through a drawdown of reserves. Additional savings were achieved in operational costs across services and higher income from the Port Health services, Barbican customer receipts, grants and investment income.</p> <p>The 2016/17 budget included a £200 million contribution payable to Crossrail on the condition that certain project milestones had been met. This contribution was paid on 28 March 2017 after completion of the four required milestones and was funded through reserves that been assembled over the past few years from a planned strategy in relation to investment properties.</p> <p>The MFTS forecasts a surplus of £10.9 million in 2017/18, moving into a breakeven position in 2018/19 and then into deficits of £15.6 million in 2019/20 and £19.4 million in 2020/21. The deficits are as a result of budgeted revenue costs for the Museum of London relocation project. The relocation project has a number of funding options that are being considered in order to cover the costs. Excluding these costs the City Fund is forecast to be in surplus throughout the period.</p> <p>The projections are based on conservative income growth from business rates, council tax, rental income and other income streams as well as budgeting for increased expenditure in relation to pay rises, increased employer contributions to tackle the pension fund deficit, additional funding for City Police and increased expenditure to fund specific improvements to services and estimated increases in demand.</p>	<p>There are healthy levels of reserves available to support City Fund's services in the medium term and we are satisfied that there are appropriate arrangements in place to continue to remain financially sustainable over the period of the MTFS.</p>

APPENDIX

REPORTS ISSUED

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

REPORT	DATE
Audit plan - City Fund	18 April 2017
Audit plan - pension fund	18 April 2017
Audit completion report - City Fund	29 September 2017
Audit completion report - pension fund	20 July 2017
Annual audit letter	19 October 2017

FEES

We reported our original fee proposals in our audit plans.

AUDIT AREA	FINAL FEES £	PLANNED FEES £
City Fund audit - scale fees	86,383	86,383
Pension fund audit - scale fees	21,000	21,000
Housing benefits subsidy certification fees	11,205	11,205
Total audit fees	118,588	118,588
Pooled housing receipts certification	2,340	2,340
Teachers pensions return (local authority)	4,500	4,500
Teachers pensions return (Centre for Young Musicians)	4,500	4,500
Audit related services fees	11,340	11,340
Other non-audit services	-	-
Total assurance services	129,928	129,928



FOR MORE INFORMATION:

LEIGH LLOYD THOMAS
Engagement lead

T: +44 (0)20 7893 2616
E: leigh.lloyd.thomas@bdo.co.uk

KERRY BARNES
Manager

T: +44 (0)20 7893 3837
E: kerry.barnes@bdo.co.uk

The matters raised in our report prepared in connection with the audit are those we believe should be brought to the attention of the organisation. They do not purport to be a complete record of all matters arising. No responsibility to any third party is accepted.

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