



CITY OF LONDON CORPORATION - CITY FUND AND PENSION FUND

ANNUAL AUDIT LETTER

Audit for the year ended 31 March 2016



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 financial year ended 2015/16. The City Fund is the part of the Corporation which carries out its functions as a local authority, port health authority and police authority. 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 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 are also required to report where we have exercised our statutory powers under the Local Audit and Accountability Act 2014 in any matter and our grant claims and returns certification work.

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.

Audit conclusions

FINANCIAL STATEMENTS

We issued unqualified true and fair opinions on the City Fund and pension fund financial statements on 27 September 2016.

We reported our detailed findings to the Audit and Risk Management Committee on 13 September. The published financial statements included a number of amendments requested by audit.

USE OF RESOURCES

We issued an unqualified conclusion on the Corporation's arrangements for securing economy, efficiency and effectiveness in its use of resources in respect of the City Fund on 27 September 2016.

Whilst we concluded that the City Fund overall remains financial resilient, the City Police budget requires action to address the budget shortfall in the short to medium term.

EXERCISE OF STATUTORY POWERS

We have not exercised our statutory powers and have no matters to report.

GRANT CLAIMS AND RETURNS CERTIFICATION

Our review of grant claims and returns is in progress and the results will be reported upon completion of this work.

FINANCIAL STATEMENTS

OPINION

We issued unqualified true and fair opinions on the City Fund and pension fund financial statements on 27 September 2016.

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, the 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 directing of the efforts of the audit team.

REVENUE RECOGNITION	RESPONSE	FINDINGS
Risks of fraud in revenue recognition may arise from the use of inappropriate accounting policies, failure to apply the Corporation's stated accounting policies or from an inappropriate use of estimates in calculating revenue.	Our review of revenue recognition focused on testing completeness and existence of fees, charges and property rental income and whether any conditions attached to grants have been met.	We did not identify any material differences in revenue recognised in the Comprehensive Income and Expenditure Statement. However, we identified one error of £0.3 million for property rental income that has been recorded as 2015/16 income but which should have been recorded in 2016/17.
For the pension fund, this included contributions income from employees and employers.	Our review of the pension fund income focused on testing the completeness and accuracy of contributions due.	We did not identify any material differences in revenue recognised in the pension Fund Account. However, we identified differences between payroll listings and the accounts in relation to contribution amounts for both employee and employer contributions for the City of London and Museum of London. Management carried out a reconciliation exercise and corrected mis-coding of contributions between the City of London and Museum of London.

FINANCIAL STATEMENTS

Continued

ACCOUNTING FOR LEASE PREMIUMS	RESPONSE	FINDINGS
<p>The City Fund is party to a significant number of lease arrangements as lessor. The premiums and rents are apportioned between the land element, which will ordinarily be an operating lease recognised as revenue, and the building element which is likely to be a finance lease and recorded as a capital disposal.</p> <p>The element of the premium relating to the land is treated as deferred income and released to revenue over the term of the lease.</p> <p>There are a number of complex judgements to allocate the premium between the land and buildings, and to account for the transactions appropriately.</p>	<p>We tested a larger number of lease transactions, and all new leases with lease premiums entered into during the year, and re-performed the accounting calculations.</p> <p>We also met with management and the City Surveyors to discuss the process applied for apportioning the significant lease premiums received in 2015/16 between land and buildings.</p> <p>As part of this meeting, we agreed that management would restate the value of the Bernard Morgan House asset held for sale as at 31 March 2015 (£7.2 million) from assets held for sale to surplus assets as a lease was issued rather than a sale/disposal. The value of the asset was then revalued to £30.4 million to reflect the lease premium received and the asset reclassified as investment properties 2015/16.</p>	<p>We were satisfied with land and building apportionments for leases and recognition of the associated lease premium between deferred income and capital receipts.</p> <p>However, our testing of the accounting treatment for the lease premium received in 2015/16 in relation to No.1 Alie Street investment land identified that £6.2 million of the total lease premium received had not be added to the carrying value of the asset. This resulted in an understatement to investment properties disclosed in the balance sheet and to the gain on revaluation of investment properties as part of the surplus on the provision of services in the Comprehensive Income and Expenditure Statement by £6.2 million.</p>

FINANCIAL STATEMENTS

Continued

LAND AND BUILDINGS VALUATIONS	RESPONSE	FINDINGS
<p>The valuations for land and buildings included in Property, Plant and Equipment is estimated based on market values for existing use or depreciated replacement cost (DRC).</p> <p>We identified a risk that the basis of valuation for these assets may not be appropriate or may not be supported by available valuation data.</p> <p>The Corporation engaged a number of valuers to value its assets at 31 March 2016. This resulted in a net upwards revaluation movement of £81.9 million in the year.</p>	<p>We reviewed the valuations provided and the valuation methodology applied. We tested a larger sample of valuations to underlying information such as rental agreements.</p> <p>We compared the valuations to expected movements using available market information.</p>	<p>We were satisfied that the basis of valuation for assets is appropriate and based on Code requirements.</p> <p>However, we found that the valuation of the Barbican Estate residential properties had used incorrect rental amounts and as a result the valuations for these properties were overstated by £4.6 million.</p> <p>We also observed that the useful economic life for dwellings has been set at 125 years based on the usual term for leases granted. This is significantly longer than used by other local authorities.</p>
INVESTMENT PROPERTY VALUATIONS	RESPONSE	FINDINGS
<p>The Code of Practice on Local Authority Accounting 2015/16 introduced a change in the basis of valuation of investment properties under International Financial Reporting Standard (IFRS) 13, from market value as an investment property to a 'highest and best use' valuation. We identified a risk that the valuations may fail to take into account the potential alternative uses of the properties in updating the valuations.</p> <p>The Corporation engaged an external valuer to value its assets at 31 March 2016. This resulted in a gain of £180 million for investment properties for the year.</p>	<p>We reviewed the valuations provided and considered how the valuer had considered the potential for changes to valuations for highest and best use. We tested a larger sample of valuations to underlying information such as rent or lease agreements.</p> <p>We compared the valuations to expected movements using available market information and investigated reasons for valuation movements on each investment property that exceeded our tolerable amounts.</p>	<p>We were satisfied that the basis of valuation for investment properties is appropriate and based on Code requirements.</p> <p>The increase valuations mainly relates to a general increase in the market (using the IPD capital index for City office space). For those properties where the market value had significantly increased or decreased this was agreed to changes in rental amounts, change in property use and receipt of lease premiums.</p>

FINANCIAL STATEMENTS

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PENSION LIABILITIES	RESPONSE	FINDINGS
<p>An actuarial estimate of the pension fund liability to pay future pensions, and the City Fund's share of the local government scheme and police pension scheme, is calculated by an independent firm of actuaries with specialist knowledge and experience. The estimate has regard to local factors such as mortality rates and expected pay rises along with other assumptions around inflation.</p> <p>At 31 March 2016 the total liabilities for the pension fund decreased by £41 million to £1,311 million. Net liabilities after reducing this for the assets held fell by £38 million to £510 million.</p> <p>The City Fund's share of the net liabilities decreased by £8.6 million for the local government scheme and by £36.9 million for the police pension scheme. This was mainly as a result of the lower discount rate applied to the liabilities.</p>	<p>We reviewed the reasonableness of the assumptions applied by comparing these to the expected ranges provided by an independent consulting actuary report.</p> <p>The key changes to the financial assumptions related to:</p> <ul style="list-style-type: none"> • A reduction in the pension increase rate from 2.4% to 2.3% • A reduction in the salary increase rate from 3.9% to 3.8% for local government workers and 4.2% to 4.1% for police • An increase in the discount rate from 3.3% to 3.6% (to place a current value on the future liabilities through the use of a market yield of corporate bonds). 	<p>We were satisfied that the assumptions used were not unreasonable or outside of the expected ranges.</p> <p>However, when reviewing the actuary report for the police pensions it was noted that this had double counted the computation lump sums. The actuary provided revised calculations to correct this error which resulted in an additional charge of £2.5 million to the Comprehensive Income and Expenditure Statement offset by an increasing actuarial gains arising from financial assumptions of £0.6 million.</p>

FINANCIAL STATEMENTS

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BUSINESS RATE APPEALS PROVISION	RESPONSE	FINDINGS
<p>Billing authorities are required to estimate the value of potential refund of business rates arising from rate appeals, including backdated appeals. The Valuation Office Agency (VOA) provides information regarding the appeals currently being assessed and settled. Management use this information to calculate a success rate for specific business types for settled appeals, and applies an appropriate rate to each type of business appeal still outstanding at year end.</p> <p>We considered there to be a risk in relation to the estimation of the provision due to potential incomplete data and assumptions used in calculating the likely success rate of appeals.</p>	<p>We reviewed the current list of appeals provided by the VOA and agreed this to the data used by management.</p> <p>We checked the calculations for the success rates for outstanding appeals and agreed this to the calculation of the provision for each category of appeal.</p>	<p>No issues were identified.</p>

FINANCIAL STATEMENTS

Continued

ALLOWANCE FOR NON RECOVERY OF RECEIVABLES	RESPONSE	FINDINGS
<p>The City Fund included a material amount in respect of provisions for non-collection of NDR, rents and sundry debt arrears. The provision was based on management assumptions in relation to the collection of the debt.</p> <p>We identified a risk that the provisions may not accurately reflect collection rates based on age or debt recovery rates.</p>	<p>We reviewed provision rates applied by management with collection rates and write off data available.</p>	<p>We were satisfied that the provisions for non-recovery of receivables were reasonable.</p> <p>However, we observed that for some of the older debt, where management had applied a collective impairment allowance for similar debt, that the rates used were taken from historic information provided by CIPFA or from high level assumptions. Management should periodically test that these rates remain appropriate based on current data.</p>

FINANCIAL STATEMENTS

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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 £5.3 million. This was determined with reference to a benchmark of gross expenditure (of which it represents 1.5 per cent) which we consider to be one of the principal considerations for the City Fund in assessing the financial performance.

The materiality for the pension fund's financial statements as a whole was set at £8.2 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 £100,000 for the City Fund and £160,000 for the pension fund.

Audit differences - City Fund

All audit differences were corrected in the final published financial statements.

This resulted in the surplus for the year increasing by £3.4 million (to £198.2 million) and net assets reducing by £0.5 million (to £1,555.4 million).

Adjustments impacting on the surplus for the year:

- (£0.3) million rental income that related to the following financial year
- (£2.5) million understated police pension expenditure
- +£6.2 million understated valuation when accounting for lease premium received

Further adjustments to net assets:

- (£4.6) million overstated valuation error on the Barbican estate assets
- +£0.7 million adjustment to the actuarial gain on police pension liability.

Audit differences - pension fund

All audit differences were corrected in the final published financial statements.

This resulted in the fund account deficit for the year decreasing by £0.4 million (to £21.5 million) and net assets increasing (to £802.2 million).

- (£0.3) million increase in fund manager fees
- +£0.7 million in investment valuations.

FINANCIAL STATEMENTS

Continued

Other matters we report on

Annual governance statement

We were satisfied that the Annual Governance Statement was not misleading or inconsistent with other information we were aware of from our audit.

Narrative reporting

Local authorities are required to include a narrative report in the Statement of Accounts to offer interested parties an effective guide to the most significant matters reported in the accounts. The narrative report should be fair, balanced and understandable for the users of the financial statements.

We were satisfied that the information given in the narrative report for the financial year for which the financial statements are prepared was consistent with the financial statements.

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.

We have completed our review 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.

The DCT was amended as a result of the audit and our assurance statement was submitted on 19 October 2016. We reported one mapping issue within the DCT but other than this we concluded that the DCT was consistent with the financial statements.

USE OF RESOURCES

CONCLUSION

We issued an unqualified conclusion on the Corporation's arrangements for securing economy, efficiency and effectiveness in its use of resources in respect of the City Fund on 27 September 2016.

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 knowledge obtained from your previous auditor, 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 directing of the efforts of the audit team.

SUSTAINABLE FINANCES POLICE	RESPONSE	FINDINGS
<p>There remains a budget gap in the City Police Medium Term Financial Strategy (MTFS) that needs to be addressed.</p> <p>In 2015/16, net expenditure (to be met from government grants, local taxation and transfers to/from reserves), was £67.4 million against a budget of £66 million. The overspend of £1.4 million was met from a transfer from the Police reserve.</p>	<p>We reviewed the financial performance of City Police and its financial sustainability through review of the medium term financial and strategic plans.</p> <p>The update to the MTFS to 2018/19 forecast current budget gaps for City Police in 2017/18 (£2.9 million) and 2018/19 (£4.8 million) which included current earmarked reserves being exhausted during 2018.</p> <p>Management are currently reviewing the financial strategy to balance the budget over the medium term. The strategy includes maximising opportunities to increase income, exploring potential additional funding streams and further efficiencies and controls on expenditure.</p>	<p>It is essential that City Police ensure that cost models supporting service delivery are accurate and up-to-date in order to clearly represent resources required in the medium term. The current MTFS requires significant savings that are currently not supported by robust plans.</p> <p>City of London Corporation, as a whole organisation, are in a position to fund current forecast deficits in respect of City Police and on that basis we concluded that City Police remain financially sustainable over the period of the MTFS.</p>

USE OF RESOURCES

Continued

SUSTAINABLE FINANCES CITY FUND	RESPONSE	FINDINGS
<p>While the City Fund forecast surpluses in the next few years following the favourable grant settlement, this included assumptions around income growth from business rates and a programme of savings.</p> <p>In 2015/16 the City Fund delivered a surplus £0.8 million mainly due to slippage/re-phasing of major revenue repairs and increased rent income from investment properties.</p>	<p>We reviewed the financial performance of the City Fund and its financial sustainability through review of the medium term financial and strategic plans.</p> <p>At 31 March 2016 usable reserves amounted to £258.2 million and, of this, £200 million was committed to the Crossrail capital project and also included sums earmarked for purposes such as Highways, HRA and the Police.</p> <p>The medium term financial forecast (MTFF) projections were 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, heightened security measures, delayed cyclical repairs and provisions for service transformation.</p> <p>The MTFF was updated in June and indicated an improved position with annual surpluses of between £5 and £6 million across the forecast period. However, some of these assumptions may be at risk due to the potential impact arising from Brexit.</p> <p>Nevertheless, City Fund finances appear to be relatively robust over the medium term.</p>	<p>There are healthy levels of reserves available to support City Fund's services in the medium term therefore we were satisfied that there are appropriate arrangements in place to continue to remain financially sustainable over the period of the MTFS.</p>

EXERCISE OF STATUTORY POWERS

REPORT BY EXCEPTION

We have not exercised our statutory powers and have no matters to report.

Use of statutory powers

We have not exercised our statutory powers and have no matters to report.

Audit certificate

We issued the audit certificate to close the audit for the year ended 31 March 2016 on 27 September 2016.

GRANT CLAIMS AND CERTIFICATION

CERTIFICATION WORK

Our review of grant claims and returns for 2015/16 is in progress and the results will be reported upon completion of this work.

Housing benefit subsidy claim

Public Sector Audit Appointments Ltd has a statutory duty to make arrangements for certification by the appointed auditor of the annual housing benefit subsidy claim.

The audit of the 2014/15 housing benefits subsidy claim, completed by your predecessor auditor, found no errors in relation to the sample testing of benefits paid or other procedures required by Department for Work and Pensions.

Our work on the 2015/16 housing benefits subsidy claim is currently in progress and will be completed ahead of the submission deadline of 30 November 2016.

We will report on the key findings separately once the work has been completed.

Other claims and returns

A number of grant claims and returns that were previously included within the scope of the audit have since been removed, but Departments may still seek external assurance over the accuracy of the claim or return.

These assurance reviews are undertaken outside of our appointment by the Audit Commission or Public Sector Audit Appointments Ltd, and are covered by tripartite agreements between the Corporation, sponsoring Department and the auditor.

The Corporation has requested that we undertake a 'reasonable assurance' review, based on the instructions and guidance provided by the Departments, for the following returns for 2015/16:

- Pooling of housing capital receipts (deadline 30 November 2016)
- Teachers' pensions returns for the local education authority (City Fund) and Centre for Young Musicians (deadline 30 November 2016)

On work on these returns is currently in progress and the key findings will be reported separately.

APPENDIX

Reports issues

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

REPORT	DATE
Audit Plan - City Fund	26 February 2016
Audit Plan - pension fund	26 February 2016
Final audit report - City Fund	7 September 2016
Final audit report - pension fund	7 September 2016
Annual Audit Letter	31 October 2016

Fees

We reported our original fee for audit services proposals in our Audit Plans.

AUDIT AREA	PLANNED FEES	FINAL FEES
Code audit - City Fund	86,383	86,383
Code audit - pension fund	21,000	21,000
Certification of housing benefits subsidy	11,396	11,396
Fee for audit services	118,779	118,779
Audit related services:		
- Pooling of housing capital receipts	2,340	2,340
- Teachers' pensions (local education authority)	4,500	4,500
- Teachers' pensions (Centre for Young Musicians)	4,500	4,500
Fee for audit related services	11,340	11,340
Non audit related services:		
- None	-	-
Total fees	130,119	130,119

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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