

# The Annual Audit Letter for Sevenoaks District Council

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**Year ended 31 March 2019**

**30 August 2019**



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# Executive Summary

## Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Sevenoaks District Council (the Council) for the year ended 31 March 2019.

This Letter is intended to provide a commentary on the results of our work to the Council and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Council's Audit Committee as those charged with governance in our Audit Findings Report on 18 July 2019.

## Our work

## Respective responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council's financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council's financial statements, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

<b>Materiality</b>	We determined materiality for the audit of the Council's financial statements to be £1,110,000, which is 2% of the Council's gross revenue expenditure.
<b>Financial Statements opinion</b>	We gave an unqualified opinion on the Council's financial statements on 30 July 2019.
<b>Whole of Government Accounts (WGA)</b>	We completed work on the Council's consolidation return following guidance issued by the NAO.
<b>Use of statutory powers</b>	We did not identify any matters which required us to exercise our additional statutory powers.

# Executive Summary

<b>Value for Money arrangements</b>	We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Council on 30 July 2019.
<b>Certification of Grants</b>	We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. Our work on this claim is not yet complete and will be finalised by 30 November 2019. We will report the results of this work to the Audit Committee separately.
<b>Certificate</b>	We certified that we have completed the audit of the financial statements of Sevenoaks District Council in accordance with the requirements of the Code of Audit Practice on 30 July 2019.

## Working with the Council

During the year we have delivered a number of successful outcomes with you. We have worked with you to streamline your processes, shared our insight by providing regular audit committee updates covering best practice.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's staff.

**Grant Thornton UK LLP**  
August 2019

# Audit of the Financial Statements

## Our audit approach

### Materiality

In our audit of the Council's financial statements, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for the audit of the Council's financial statements to be £1,110,000, which is 2% of the Council's gross revenue expenditure. We used this benchmark as, in our view, users of the Council's financial statements are most interested in where the Council has spent its revenue in the year.

We set a lower threshold of £55,000, above which we reported errors to the Audit Committee in our Audit Findings Report.

### The scope of our audit

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

- the accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the Statement of Accounts to check it is consistent with our understanding of the Council and with the financial statements included in the Annual Report on which we gave our opinion.

We carry out our audit in accordance with ISAs (UK) and the NAO Code of Audit Practice. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

# Audit of the Financial Statements

## Significant Audit Risks

These are the significant risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>The revenue cycle includes fraudulent transactions (rebutted)</b></p> <p>Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue.</p>	<p>Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Council, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because:</p> <ul style="list-style-type: none"> <li>• there is little incentive to manipulate revenue recognition</li> <li>• opportunities to manipulate revenue recognition are very limited</li> <li>• the culture and ethical frameworks of local authorities, including Sevenoaks District Council, mean that all forms of fraud are seen as unacceptable</li> </ul>	<p>This risk was rebutted.</p>
<p><b>Management override of internal controls</b></p> <p>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. You face external scrutiny of your spending and this could potentially place management under undue pressure in terms of how they report performance.</p> <p>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.</p>	<p>We have</p> <ul style="list-style-type: none"> <li>• evaluated the design effectiveness of management controls over journals</li> <li>• analysed the journals listing and determined the criteria for selecting high risk unusual journals</li> <li>• where identified, tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration</li> <li>• gained an understanding of the accounting estimates and critical judgements applied made by management</li> <li>• considered their reasonableness with regard to corroborative evidence</li> <li>• evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.</li> </ul>	<p>Our audit work did not identify any issues in respect of management override of controls.</p>

**Significant Audit Risks (continued)**

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>Valuation of land and buildings</b></p> <p>The Council revalues its land and buildings on a five-yearly basis. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved (£39 million of property, plant and equipment in 2018/19) and the sensitivity of this estimate to changes in key assumptions. Additionally, management will need to ensure the carrying value in the financial statements is not materially different from the current value at the financial statements date, where a rolling programme is used.</p>	<p>We have:</p> <ul style="list-style-type: none"> <li>evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work</li> <li>evaluated the competence, capabilities and objectivity of the valuation expert</li> <li>written to the valuer to confirm the basis on which the valuation was carried out to ensure that the requirements of the Code are met</li> <li>challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding</li> <li>tested revaluations made during the year to see if they had been input correctly into the Council's asset register</li> </ul>	<p>Our audit work has not identified any issues in respect of valuation of land and buildings.</p>
<p><b>Valuation of the pension fund net liability</b></p> <p>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.</p> <p>The pension fund net liability is considered a significant estimate due to the size of the numbers involved (£87 million in the Council's balance sheet in 2018/19) and the sensitivity of the estimate to changes in key assumptions.</p>	<p>We have</p> <ul style="list-style-type: none"> <li>updated 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;</li> <li>evaluated the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work;</li> <li>assessed the competence, capabilities and objectivity of the actuary who carried out the Council's pension fund valuation;</li> <li>assessed the accuracy and completeness of the information provided by the Council to the actuary to estimate the liability;</li> <li>tested 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;</li> <li>undertaken procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performed any additional procedures suggested within the report.</li> <li>assessed the impact of the McCloud judgement) and considered management's representations and disclosures with respect to this.</li> </ul>	<p>Our consideration of the McCloud ruling identified a difference of opinion with management and an unadjusted misstatement, which was not material to the financial statements. No other issues were noted from our testing.</p>

## Significant Audit Risks (continued)

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>Group Accounts</b></p> <p>In 2015, you set up Quercus7 Limited, a subsidiary that will act as a Trading Company. In 2017 this was followed by Quercus Housing Limited, a subsidiary to enable you to provide affordable housing funded from S106 contributions.</p> <p>Quercus 7 began trading in January following its first property acquisition. While Quercus Housing is not currently trading, there is a probability that material capital acquisitions occur before year end in one or both entities.</p> <p>As these subsidiaries continue to expand, the preparation of group accounts will need to be considered going forward.</p>	<p>We have:</p> <ul style="list-style-type: none"> <li>• updated our understanding of the capital and operational activity taking place within Quercus7 and Quercus Housing;</li> <li>• evaluated management's determination and disclosures over whether group accounts are required or not.</li> </ul> <p>Management has assessed that, with respect to Quercus 7 Limited;</p> <p><i>The company has acquired its first commercial property but due to the value of the acquisition group accounts are not required. During the year the company were given credit facilities for business expenses totalling £106,569. Quercus 7 Limited also has secured long term borrowing of £321,866.</i></p> <p>...and with respect to Quercus Housing Limited;</p> <p><i>The company has not traded and has no assets and therefore there is no requirement to produce group accounts. Work undertaken by officers on company business will be charged to the company.</i></p> <p><i>During the year the company were given credit facilities for business expenses totalling £77,679.</i></p> <p>Based on the immateriality of the subsidiaries' activities and financial position for the year ended 31 March 2019, we agree with management's determination that these are not material from the perspective of the Council and that group accounts are not required.</p> <p>In June 2019, both entities made significant acquisitions. While these do not impact the 2018/19 statement of accounts (as they occurred after the 31 March 2019 year end), the size of these is likely to crystallise the need for group accounts in 2019/20.</p>	<p>We agreed with management's determination that the activities of your subsidiaries are not material for the year ended 31 March 2019.</p>

# Audit of the Financial Statements

## **Audit opinion**

We gave an unqualified opinion on the Council's financial statements on 30 July 2019.

## **Preparation of the financial statements**

The Council presented us with draft financial statements in accordance with the national deadline, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit.

## **Issues arising from the audit of the financial statements**

We reported the key issues from our audit to the Council's Audit Committee on 18 July 2019.

In addition to the key audit risks reported above, we identified some minor misclassifications which management adjusted. We also identified a difference of opinion with management with respect to the accounting treatment of the McCloud ruling. This difference of opinion engendered an unadjusted misstatement, which was not material to the financial statements. This was reported to the Audit Committee as part of our audit findings.

## **Annual Governance Statement and Narrative Report**

We are required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website in line with the national deadlines.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Council and with our knowledge of the Council.

## **Whole of Government Accounts (WGA)**

We carried out work on the Council's Data Collection Tool in line with instructions provided by the NAO . We issued an assurance statement which confirmed the Council was below the audit threshold.

## **Other statutory powers**

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

## **Certificate of closure of the audit**

We certified that we have completed the audit of the financial statements of Sevenoaks District Council in accordance with the requirements of the Code of Audit Practice on 30 July 2019.

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# Value for Money conclusion

## Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 which specified the 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.*

## Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the risks where we concentrated our work.

The risks we identified and the work we performed are set out overleaf.

As part of our Audit Findings report agreed with the Council in July 2019, we agreed recommendations to address our findings.

## Overall Value for Money conclusion

We are satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2019.

# Value for Money conclusion

## Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>Governance arrangements over future income generation</b></p> <p>Income generation forms a key part of your 10-year budget; income from property investment income is planned to increase from £0.735 million per year in 2018/19 to £1.655 million per year in by 2028/29.</p> <p>Alongside the existing Property Investment Strategy, during the year, an Income Generation Group (IGG) (led by the Head of Finance) was set up for the purpose of looking at existing income streams but also as a forum for identifying new opportunities and putting business cases in place for consideration at a Strategic Management Team level.</p> <p>Your financial planning has historically been accurate and robust, and you have a track record of achieving your planned results. Moreover, through the Property Investment Strategy you already have organisational experience of property investment more broadly. However, all forms of income generation carry an element of risk and need to be supported by informed decision making.</p>	<p>We reviewed your project management and risk assurance frameworks to understand how you are identifying, managing and monitoring risks and considered these arrangements against good practice. We also considered the composition, structure and outputs of the IGG and how effective these arrangements are in enabling you to obtain value for money from income generation opportunities.</p>	<ul style="list-style-type: none"> <li>• The governance arrangements for Quercus 7 Ltd and Quercus Housing are defined by way of a shareholders agreement and guarantors agreement respectively.</li> <li>• Although there were no significant acquisitions during the review period, two significant acquisitions took place after year end, being an Industrial unit in Canterbury, purchased through Quercus 7 for £2.19m in June 2019 and the purchase of 14 flats in Westerham (within the District) for £3.6m in June 2019, with 9 flats to be let by Quercus Housing for affordable housing and 5 flats let by Quercus 7 for private sector rental.</li> <li>• Both of these acquisitions were in line with the your strategic aims and in line with your income generation targets.</li> <li>• You have also demonstrated that you are willing to consider, but ultimately reject opportunities which fall outside your areas of expertise. During the year, an 'Income Strip' scheme was considered, which would have potentially committed the Council to a long term financing arrangement outside of the Borough. A member group was created to consider this and professional advice sought. The specifics of the arrangement were rejected, for a number of reasons including the level of risk involved in this specific scheme, although future arrangements of this nature have not been ruled out if circumstances support this. The ability to actively consider and reject options shows a level of institutional maturity with respect to income generation.</li> <li>• The income generation group is comprised of the Head of Finance, who acts as Chair, and a cross-section of senior management (Corporate Customer Service and Delivery Manager, Corporate Projects; Building Control Partnership Manager; Head of Direct Services; Head of Economic Development and Property.)</li> <li>• The first Income Generation Group took place in December 2018, although the Group has not yet met since.</li> </ul>

# Value for Money conclusion

## Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>Governance arrangements over future income generation (continued)</b></p> <p>Part of your wider income generation plans will be delivered through subsidiary companies. In 2015, you set up Quercus7 Limited, a subsidiary that will act as a Trading Company. In 2017 this was followed by Quercus Housing Limited, a subsidiary to enable you to provide affordable housing funded from S106 contributions.</p> <p>Quercus 7 began trading in January following its first property acquisition. While Quercus Housing is not currently trading, there is a probability that significant capital acquisitions occur before year end in one or both entities.</p> <p>Although fully owned by Sevenoaks District Council, the two subsidiaries are legally separate entities. The acquisition strategy set out in the Property Investment Strategy aims to integrate the activities of Quercus7 (although not Quercus Housing, which is funded separately through S106 contributions) into your overall strategy, and so governance and oversight arrangements will need to be effectively integrated to ensure appropriate value for money is being obtained.</p>	<p>As a result of the work we performed, we recommended that as part of the establishment of a terms of reference for the Income Generation Group, the relationship between elected Councillors and officers is clearly defined in such a way that fosters member interest and expertise, but in such a way that is not disproportionately influenced by electoral cycles.</p> <p>Management accepted this recommendation, advising that “As part of the budget process each year, Members are asked for their income generation ideas. Where a Member has particular expertise relating to a specific idea, they may be invited to attend an Income Generation Group meeting to provide additional information on that idea.”</p>	<ul style="list-style-type: none"> <li>• In May 2019, the a local election took place. Members were elected for all wards within the District. Our discussions with management have identified that there are a number of members who have expressed interest in generating ideas with respect to income generation.</li> <li>• Currently, there is no member representation on the Income Generation Group. The extent to which members should have a direct role in management functions with respect to Income Generation is a matter of local judgement; good practice seen elsewhere indicates that there is no ‘one size fits all’ approach.</li> <li>• As part of our publication In Good Company (September 2018) we commented that while Local Authority Trading Companies can represent an effective way of promoting commercialisation in a way that is consistent with a local authorities aims, there is an important balance to be struck to ensure that the governance structure is set up in such a way that member input is fostered positively, but in a sustainable way that is not disproportionately influenced by electoral cycles.</li> <li>• The Income Generation Group does not currently have a formal of terms of reference. Management have already identified the need for this, and there is a plan to have a terms of reference established in time for the group’s next scheduled meeting in July.</li> <li>• It is noted that the Income Generation Group aims to input into the budget setting process for 2020/21. As part of the determination of a terms of reference, management will need to define what the long term approach will be to member involvement.</li> </ul>

## A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit and confirm there were no fees for the provision of non audit services/

### Reports issued

Report	Date issued
Audit Plan	14 March 2019
Audit Findings Report	5 July 2019
Annual Audit Letter	30 August 2019

### Fees

	Planned fees £	Actual fees £	2017/18 fees £
Statutory audit	33,230	37,630	43,156
Housing Benefit Grant Certification	17,500	20,500	13,845
<b>Total fees</b>	<b>50,730</b>	<b>58,130</b>	<b>57,001</b>

### Audit fee variation

As outlined in our audit plan, the 2018-19 scale fee published by PSAA of £33,230 assumes that the scope of the audit does not significantly change. There are a number of areas where the scope of the audit has changed, which has led to additional work. These are set out in the following table.

Area	Reason	Fee proposed
<b>Assessing the impact of the McCloud ruling</b>	The Government's transitional arrangements for pensions were ruled discriminatory by the Court of Appeal last December. The Supreme Court refused the Government's application for permission to appeal this ruling. As part of our audit we have reviewed the revised actuarial assessment of the impact on the financial statements along with any audit reporting requirements.	£1,600
<b>Pensions – IAS 19</b>	The Financial Reporting Council has highlighted that the quality of work by audit firms in respect of IAS 19 needs to improve across local government audits. Accordingly, we have increased the level of scope and coverage in respect of IAS 19 this year to reflect this.	£1,200
<b>PPE Valuation – work of experts</b>	As above, the Financial Reporting Council has highlighted that auditors need to improve the quality of work on PPE valuations across the sector. We have increased the volume and scope of our audit work to reflect this.	£1,600
<b>Total</b>		£4,400

## A. Reports issued and fees continued

We confirm below our final reports issued and fees charged for the audit and provision of non-audit services

### Fees for non-audit services

Service	Fees £
<b>Audit related services</b>	20,500
- Certification of Housing Benefit Grant	
<b>Non-Audit related services</b>	Nil
- None	

### Non- audit services

- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The table above summarises all non-audit services which were identified.
- We have considered whether non-audit services might be perceived as a threat to our independence as the Council's auditor and have ensured that appropriate safeguards are put in place.

The above non-audit services are consistent with the Council's policy on the allotment of non-audit work to your auditor.



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