



The Annual Audit Letter for Swale Borough Council

Year ended 31 March 2020

January 2021



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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 Swale Borough Council (the Council) for the year ended 31 March 2020.

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 work in our Audit Findings Report to the Council's Audit Committee as those charged with governance on 25 November 2020.

Our work

Materiality	We determined materiality for the audit of the Council's financial statements to be £1,565,000, which is approximately 2% of the Council's gross revenue expenditure.
Financial Statements opinion	<p>We gave an unqualified opinion on the Council's financial statements on 27 November 2020.</p> <p>Our report included an emphasis of matter in respect of the impact of the Covid-19 pandemic on the valuation of the Council's land and buildings, holding in a property investment fund and share in the Kent Pension Fund's property investments as at 31 March 2020. This does not affect our opinion that the statements give a true and fair view of the Council's financial position and its income and expenditure for the year.</p>
Use of statutory powers	We did not identify any matters which required us to exercise our additional statutory powers.

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 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 financial statements, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

Executive Summary

Value for Money arrangements	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 27 November 2020.
Certificate	We certified the completion of the audit of the financial statements of Swale Borough Council in accordance with the requirements of the Code of Audit Practice on 27 November 2020.

Working with the Council

Both the Council and the audit team moved to remote working arrangements in March 2020. We continued to have regular contact with the Council throughout our audit of the financial statements, although the remote working arrangements meant that our audit took longer to complete.

We would like to take this opportunity to record our appreciation for the assistance provided by the Council's staff during the audit, particularly given the additional issues associated with remote working as a result of the pandemic.

Grant Thornton UK LLP January 2021

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 to evaluate 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 £1,565,000, which is approximately 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 level of materiality, £500,000, for our review of the Council's bank and cash balances, as any error in this area might have added significance for the accounts as a whole.

We set a threshold of £78,000 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 other information published with the financial statements (including the Annual Governance Statement and the Narrative Report) to check that this is consistent with our understanding of the Council.

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

We identified significant 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>Covid-19 The global Covid-19 pandemic has led to unprecedented uncertainty for all organisations, including the Council. We identified risks relating to;</p> <ul style="list-style-type: none"> the impact of remote working arrangements on the Council's process for producing the financial statements, and on the audit team's ability to obtain sufficient, appropriate audit evidence to support our opinion; the greater uncertainty applying to assumptions and estimates made by management, including the potential impact of market volatility on property valuations; and the need for appropriate disclosures in the financial statements on the impact of the pandemic. 	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> worked with management to understand the implications of the response to the pandemic on the Council's ability to prepare the 2019/20 financial statements; evaluated the adequacy of the disclosures in the financial statements in the light of the pandemic; evaluated whether sufficient audit evidence could be obtained through remote technology; and evaluated whether sufficient audit evidence could be obtained to corroborate significant management estimates such as the valuations for property assets. 	<p>The Council moved to a remote working environment in March 2020. However, there has been no indication of high sickness levels, changes in roles and responsibilities or IT systems issues with a significant impact on the workings of the finance team.</p> <p>Management concluded that all valuations in respect of the Council's land and buildings, holdings in property investment funds, and share in the Kent Pension Fund's property investments should be reported on the basis of "material valuation uncertainty".</p> <p>Our audit opinion includes an emphasis of matter drawing attention to this disclosure in the financial statements.</p>

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>Valuation of land and buildings The Council revalues its Property, Plant and Equipment (PPE) assets using a 5-year rolling programme, but with all major assets revalued annually. The Council also performs work each year to confirm that the carrying value of all assets at the balance sheet date is not materially misstated, even if a full revaluation has not been performed. All Investment properties are revalued annually.</p> <p>The valuation of these assets represents a significant estimate by management in the financial statements.</p> <p>We designed our work to address the risk that the valuation of land and building assets was materially misstated.</p>	<p>As part of our audit work we;</p> <ul style="list-style-type: none"> evaluated management's processes for the calculation of the estimate, including the instructions issued to the Council's external valuers and the scope of their work; evaluated the competence, capabilities and objectivity of the external valuers; challenged the information and assumptions used by the Council's external valuers, tested revaluations made during the year to see if they had been input correctly into the Council's asset register; and evaluated how management concluded that the carrying value of assets not revalued was not materially misstated. 	<p>We noted that an accrual for capital expenditure totalling £778,000 had been omitted from the accounts. The value of PPE assets was therefore understated by this amount. Management agreed to amend the accounts.</p> <p>The Council's leisure centres are valued on a Depreciated Replacement Cost (DRC) basis. This methodology requires an estimate of the building costs required to replace the building, including the use of a "location factor" based on geographical area. For one asset the location factor differed from that used in the calculations for other DRC assets. We agreed that the same location factor should be used in all DRC valuations. The impact was to increase the value of PPE assets by £333,000. Management agreed to amend the accounts.</p> <p>The Council owns three small parcels of land at Fountain Street, Sittingbourne. These sites were valued on different bases. It was not clear that this was appropriate. The Council's external valuer estimated the potential impact if all three sites had been valued on the same basis, taking into account their potential for affordable housing use; the impact was to increase the aggregate value, but not by a material amount. We concluded that there was no material issue for our opinion and the accounts were not amended.</p> <p>In December 2019 the Council terminated its development agreement with Spirit of Sittingbourne PLC (SoS PLC); as part of the termination agreement it made a payment to the company. In the financial statements this payment was treated as capital expenditure and accounted for as an addition to PPE assets. We considered the accounting treatment for this transaction. Under IAS 16b the costs of an item of property, plant and equipment include "any costs directly attributable</p>

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>Valuation of land and buildings (continued)</p>		<p>to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management".</p> <p>We noted that in late 2019 the Council wished to investigate alternative options for these sites, including affordable housing. Management's view was that, under the conditions stipulated by the development agreement, if the agreement had not been terminated the land would have been transferred outside of the Council's control and the sites could not have been used for other purposes. We also noted that the settlement payment was not a material transaction in the accounts. In October 2019 management reported that the estimated value of the three sites which would transfer to SoS PLC exceeded the amount of the settlement payment. We noted that at 31 March 2020 the three sites were valued by the external valuer at an aggregate value lower than the settlement. We concluded that there was no material issue for our opinion.</p> <p>Our audit work did not identify any other issues in respect of the valuation of land and buildings.</p>

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>Valuation of net pension liability</p> <p>The Council's financial statements include a net liability in respect of the Local Government Pension Scheme (LGPS). This represents a significant estimate in the financial statements.</p> <p>We designed our work to address the risk that the pension fund net liability was materially misstated</p>	<p>As part of our audit work we;</p> <ul style="list-style-type: none"> identified and evaluated the design of the controls put in place to ensure that the pension fund net liability was not materially misstated; assessed the competence, capabilities and objectivity of the actuary who carried out the Authority's pension fund valuation assessed the accuracy and completeness of the information provided by the Authority to the actuary; confirmed the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary PWC (as auditor's expert) and performing the additional procedures suggested within the report; checked that the disclosures on pensions included in the financial statements were consistent with the actuary's report; and obtained assurance from the auditor of the Kent Pension Fund (KPF) on the validity and accuracy of the membership, contributions and benefits data provided by KPF to the actuary, and used by the actuary to calculate the Council's net pension liability. 	<p>In December 2018 the Court of Appeal ruled that provisions in some public sector pension schemes were discriminatory on the basis of age, the so-called "McCloud" judgement. This ruling has implications for other pension schemes, including the LGPS. The Council's actuary has estimated that the impact of the ruling is to increase the Council's overall pension liabilities at 31 March 2020 by £861,000.</p> <p>A consultation by HM Treasury on the next phase of the Government's response to address this discrimination commenced in July 2020. This process may lead to changes in the liabilities arising out of the judgment. Management have concluded that the issue is not material. No additional disclosure has been included in the accounts.</p> <p>We concluded that there was no material issue for our opinion.</p>

Audit of the Financial Statements

Significant Audit Risks - continued

These are the 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>Management override of internal controls</p> <p>Under ISA (UK) 240 there is a non-rebuttable presumption that the risk of management over-ride of controls is present in all entities.</p> <p>The Council faces external scrutiny of its spending and this could potentially place management under undue pressure in terms of how they report performance.</p> <p>We designed our work to address the risk associated with management override of internal controls.</p>	<p>As part of our audit work we;</p> <ul style="list-style-type: none"> evaluated the design effectiveness of management controls over journals; identified and tested unusual journal entries for appropriateness; gained an understanding of the accounting estimates, judgements applied and decisions made by management, and considered their reasonableness; and evaluated the rationale for any changes in accounting policies or significant unusual transactions. 	<p>We considered the disclosures on estimation uncertainty relating to the pandemic and agreed a number of changes with management.</p> <p>We did not identify any other issues in respect of management override of controls.</p>

Audit of the Financial Statements

Audit opinion

We gave an unqualified opinion on the Council's financial statements on 27 November 2020.

Issues arising from the audit of the financial statements

As a result of the Covid-19 pandemic remote working arrangements for both the Council and the audit team have been in place throughout the audit. This has meant that the audit has taken longer to complete, with screen-sharing and other procedures required to obtain appropriate supporting evidence.

Additional work has also been required in 2019/20 to address the depth and challenge of work now required by the Financial Reporting Council in areas such as the valuation of property assets and the Council's net pension liability.

As in previous years the standard of the Council's draft financial statements was high. The working papers produced by the finance team to support the accounts were also of a high standard. This performance was especially commendable given the challenging environment created by the pandemic.

We reported the key issues from our audit to the Council's Audit Committee on 25 November 2020.

Annual Governance Statement and Narrative Report

We are required to review the Council's Annual Governance Statement and Narrative Report.

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

Whole of Government Accounts (WGA)

We carried out work in accordance with instructions issued by the NAO. We issued an assurance statement confirming that a review of the Council's data collection tool was not required as the values in the financial statements were below the specified threshold.

Certificate of closure of the audit

We certified that we have completed the audit of the financial statements of Swale Borough Council in accordance with the requirements of the Code of Audit Practice on 27 November 2020.

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 April 2020 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 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.

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 2020.

Value for Money conclusion

Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Financial sustainability</p> <p>We identified a significant risk in respect of the Council's arrangements to ensure financial sustainability.</p>	<p>The Council has a history of strong financial management. In recent years it has had a structured approach to addressing the impact of ongoing reductions in government funding, both by making financial savings and through developing alternative sources of income. In this period it has regularly delivered underspends against revenue budget, including an underspend of £64,000 for 2019/20; it has also made significant contributions to reserves to address future uncertainties, including creating a business volatility reserve to manage fluctuations in income from business rates. The Council has usable reserve balances of £23,453,000 at 31 March 2020. However, it has continued to face financial pressures, and has made contributions from reserves to support the revenue budget in both 2018/19 and 2019/20.</p> <p>The impact of the Covid 19 pandemic on the Council's financial position in 2019/20 has been limited, with lockdown arrangements commencing in late March 2020. However, the impact on the Council's finances in 2020/21 is likely to be significant, with a further impact in future years.</p> <p>The Council faces pressures both from the loss of income and additional costs. The loss of income reflects the impact of wider economic conditions, including reduced income from fees and charges (mainly income from car parks), and from delays in opening the leisure phase of the Sittingbourne Town Centre regeneration project. There may also be reductions in collection rates for council tax and business rates. The Council anticipates that costs associated with homelessness will increase as a result of the pandemic. There may also be additional costs associated with the Council's leisure centres, which are operated by third parties. A tranche of government funding for leisure centres was announced in October 2020, but prior to this leisure centre operators were not eligible for financial support, with lockdown arrangements leading to significant additional costs and reductions in income. The Council has agreed to provide additional support of £125,000 to two leisure centre operators to address these pressures. It is considering if further support will be required.</p> <p>The Council has received four tranches of emergency funding from central government totalling £2,922,000. Additional support, estimated to be approximately £650,000, is anticipated under government plans to compensate councils for the potential loss of income from fees and charges.</p>	<p>We concluded that the risk we identified was sufficiently mitigated and that the Council has proper arrangements for securing economy, efficiency and effectiveness in the use of resources.</p>

Value for Money conclusion

Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Financial sustainability (continued)</p>	<p>An updated assessment of the financial impact of the pandemic was reported to September Cabinet. This forecast a substantial revenue overspend in 2020/21 compared with original budget, with an overall adverse financial impact of £700,000. This forecast takes into account the financial support from government notified to that point, but not the most recent, fourth, tranche of support funding totalling £1,027,000. This forecast continues to be updated as new information is received.</p> <p>The Council is currently modelling the impact of the pandemic on the Council's Medium Term Financial Plan (MTFP). The previous version of the MTFP, updated prior to the pandemic, identified a residual funding gap (after delivering service savings) of £1.2m for 2021/22. You have identified a number of risks to the Council's position in future years associated with the additional costs and loss of income arising from the pandemic. A further update will be provided to Cabinet in December.</p> <p>We concluded that going forward the Council is now likely to face very significant financial pressures. Considerable uncertainty still remains over the final scale and timing of these pressures, in part depending on the extent and duration of any downturn in the wider economy, and how far permanent changes in behaviour arising from the pandemic have an impact on the Council's income streams. The Council will need to regularly review the planning assumptions supporting the MTFP. It will also need to take early and credible action to address any budget gaps to ensure it has a sustainable financial framework over the medium term.</p>	

A. Reports issued and fees

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

Reports issued

Report	Date issued
Audit Plan	March 2020
Audit Findings Report	November 2020
Annual Audit Letter	January 2021

Fees

	Planned fees £	Actual fees £	2018/19 fees £
Statutory audit	54,269	62,409	51,169
Total fees	54,269	62,409	51,169

Fees for non-audit services

	Planned fees £	Actual fees £	2018/19 fees £
Audit related services	20,500	TBC	20,500
Certification of Housing Benefit Subsidy claim			
Non-Audit related services			
- None			
Total fees for non-audit services	20,500	TBC	20,500

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

Audit fee variation

As outlined in our audit plan the planned fee of £54,269 for 2019/20 was based on the assumption that the scope of our audit did not significantly change. However, for 2019/20 we have been required to perform additional work over and above that originally envisaged due to the impact of Covid 19. Our final fee is set out in the table overleaf.

The proposed fee variation is subject to approval by PSAA.

A. Reports issued and fees

Area	Reason	Fee proposed (£)
Scale fee		46,769
Raising the bar	The Financial Reporting Council (FRC) has highlighted that the quality of work by all audit firms needs to improve across local government audits. This has required additional audit planning and supervision, as well as additional challenge and scepticism in areas such as estimates, financial resilience and information provided by the entity.	2,500
Pensions – valuation of net pension liabilities under International Auditing Standard (IAS) 19	The Financial Reporting Council (FRC) has highlighted the need for improvements by all audit firms in their work on pension valuations. This has required increases in the depth of coverage and the scope of our audit challenge, with increased levels of documentation and reporting.	1,750
Property, Plant and Equipment Valuation – work of experts	The FRC has also determined that auditors need to improve the quality of work relating to the valuation of property assets. We have therefore increased the volume and scope of our work, in particular to challenge the management assumptions underpinning the valuations.	1,750
New standards / developments	The Council is required to respond effectively to new accounting standards or technical issues. Although the planned introduction from 1 April 2020 of IFRS 16 on leases was deferred, other current issues such as the government consultation on the McCloud remedy have required additional work as part of the 2019/20 accounts.	1,500
Original planned fee per Audit Plan (March 2020)		54,269
Covid 19	The impact of Covid 19 on the audit of the 2019/20 financial statements has been substantial. Remote working arrangements have required significantly more time to obtain sufficient, appropriate audit evidence. Additional work has also been required to ; -review our planning risk assessment. An audit plan addendum was issued in August 2020; -review management assumptions and estimates, particularly those relating to property valuations, given the uncertainties created by the pandemic; and -consider the impact of the pandemic on the Council's financial sustainability.	8,140
Total		62,409



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