

Members of the Audit and Governance Committee  
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31 July 2018

Dear Members of the Audit and Governance Committee

### Update to our 2017/18 Audit Completion Report

I am writing to update Members on the matters arising since we presented the Audit Completion Report to the Audit and Governance Committee on 20 July 2018.

Members will recall that I explained that due to the very tight timescales for the audit, our work would continue up to 31 July 2018, and I promised to write to Members at the point of signing off the audit, to provide an update on matters arising and how they had been resolved.

The following table describes how the outstanding matters included on page 4 of the Audit Completion Report (issued on 12 July 2018) have been addressed.

<b>Audit area</b>	<b>Description of outstanding matters on 12 July 2018</b>	<b>Updated position at the conclusion of the audit</b>
Property, Plant and Equipment valuations	Our testing of valuations is still in process.	<p>We have now completed our testing of valuations.</p> <p>A number of issues arose from this work, which are reported later in this letter, but none of the issues were material either individually or cumulatively.</p> <p>The potential error that was identified has been added as an unadjusted misstatement in Appendix A to this letter.</p>

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Audit area	Description of outstanding matters on 12 July 2018	Updated position at the conclusion of the audit
Group statements	We are still awaiting final communications from a number of component auditors.	All final communications were received from component auditors, and there were no issues arising that require reporting to Members.
Pensions work	We are still awaiting a response for our request for information from the auditor of the Tyne & Wear Pension Fund.	We received the response from the auditor of the Tyne & Wear Pension Fund, and based on our evaluation of this, there are no further issues arising in relation to pension disclosures.
Other areas	Our work is still continuing in a number of areas.	<p>Work continued in a number of areas.</p> <p>No significant issues arose in any of the other areas where work continued up to 31 July 2018.</p> <p>However, a small number of relatively minor amendments were made to the approved financial statements, in accordance with the protocol agreed at the Audit and Governance Committee on 20 July 2018.</p> <p>Although the subsequent changes were not significant, they have been listed in full in Appendix A to this letter for completeness.</p>
VFM Conclusion	Ofsted are expected to publish their updated assessment of children's safeguarding services before we issue our VFM conclusion on 31 July 2018.	Ofsted published their re-inspection report in relation to children's services on 25 July 2018. This reported that some aspects of children's services remained inadequate. We updated the wording of our 'except for' qualification to the VFM conclusion to reflect this latest reported position by Ofsted. This is reflected in our updated audit report attached as Appendix B to this letter.

## **Property, plant and equipment valuations**

Our work on property, plant and equipment included reviewing a sample of individual valuations and challenging the valuer on the basis for valuations, assumptions used and underlying data.

We identified a number of errors in the valuer's detailed calculations and we assessed the impact of these on our audit opinion.

The errors identified in our sample were:

- use of Building Cost Information Service (BCIS) indices that were outside of the interquartile range at 31 March 2018;
- minor errors in the calculation of floor areas used in calculations; and
- other minor errors.

The total value of the errors from our sample were £610k. We extrapolated these errors and this gave us a projected misstatement of £3.5m, well below materiality of £11.9m. Based on this assessment, we were satisfied that property, plant and equipment was materially fairly stated and no further amendments were required to the financial statements.

The potential error that was identified has been added as an unadjusted misstatement in Appendix A to this letter.

## **Internal control recommendations**

Two internal control recommendations arose from our final work:

### **IT assets**

#### **Description of deficiency**

We tested an item of £13k within property, plant and equipment relating to IT hardware. We sought to verify the existence of this asset based on the serial number recorded on the invoice. We were unable to trace the asset using either the serial number or the invoice details. This was because once the asset is received by the Council it is tagged and assigned an Asset number, which is not based on serial numbers or invoice numbers.

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#### **Potential effects**

Without a trail between asset records and invoices, an important element of asset verification is lost.

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#### **Recommendation**

The Council should consider recording serial numbers and invoice numbers in the register of IT assets.

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#### **Management response**

Management has agreed to review this issue.

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## **IT general controls testing**

### **Description of deficiency**

We reviewed a sample of starters and leavers to ensure that access controls to key financial systems were properly controlled. Two of the new starters checked in the SAP system were given additional access to that requested on their approval forms. Officers were unable to provide additional documentation to support the additional access rights.

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### **Potential effects**

If access rights are not properly controlled, the integrity of key financial data could be compromised.

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### **Recommendation**

The Council should ensure that all access rights to key systems are properly approved and relevant documentation retained to support this.

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### **Management response**

Management has agreed to review this issue.

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## **Summary of misstatements**

For completeness, I attach a final summary of misstatements as Appendix A to this letter. All changes between the Audit Completion Report and the final position are highlighted in red.

## **Letter of representation**

We requested an updated letter of representation from the Head of Financial Management, in light of the additional unadjusted misstatement relating to property, plant and equipment valuations. We received an updated signed letter before we issued our report.

## **Final audit report**

The wording of our final audit report, a copy of which was signed today, is attached as Appendix B.

Yours sincerely



Mark Kirkham  
Partner

## Appendix A – Summary of misstatements

The minor changes to the financial statements between the Audit and Governance Committee meeting on 20 July 2018 and the sign off date of 31 July 2018 are summarised at the end of this Appendix in red. Other than this, there is one change to the unadjusted misstatements highlighted in red below.

We set out below the misstatements identified for adjustment during the course of the audit, above the trivial threshold of £24,000.

The first table outlines the misstatements that were identified during the course of our audit which management has assessed as not being material either individually or in aggregate to the financial statements and does not currently plan to adjust.

The second table outlines the misstatements that have been adjusted by management during the course of the audit.

### Unadjusted misstatements

		<b>Comprehensive Income and Expenditure Statement</b>		<b>Balance Sheet</b>	
		Dr (£'000)	Cr (£'000)	Dr (£'000)	Cr (£'000)
1	Dr: Property, Plant and Equipment			862	
	Cr: Unusable Reserves				862

To correct the incorrect valuation information reflected in the apportionment of the Waste PFI asset values (shown net of trivial depreciation).

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2	Dr: Property, plant and equipment			3,451	
	Cr: Revaluation reserve				3,451

Errors identified in the valuer's detailed valuations; the total value of the errors from the audit sample were £610k. These errors were extrapolated giving us a projected potential misstatement of £3.5m, well below materiality of £11.9m.

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**Adjusted misstatements 2017/18 (Council)**

		<b>Comprehensive Income and Expenditure Statement</b>		<b>Balance Sheet</b>	
		Dr (£'000)	Cr (£'000)	Dr (£'000)	Cr (£'000)
1	Dr: Short Term Provisions			2,377	
	Cr: Long Term Provisions				2,377

Reclassification of part of the NNDR appeals provision from short term to long term provisions.

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**Adjusted misstatements 2017/18 (Group)**

		<b>Group Comprehensive Income and Expenditure Statement</b>		<b>Group Balance Sheet</b>	
		Dr (£'000)	Cr (£'000)	Dr (£'000)	Cr (£'000)
1	Dr: Short Term Provisions			2,377	
	Cr: Long Term Provisions				2,377

Reclassification of part of the NNDR appeals provision from short term to long term provisions.

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2	Dr: Short Term Debtors			4,576	
	Dr: Short Term Provisions			598	
	Cr: Defined Benefit Pension Scheme Liability				5,174

Together for Children Sunderland Ltd – reclassification to show deferred tax asset relating to the pension liability in debtors rather than offsetting it against the pension liability, and an adjustment to remove an element from short term provisions.

## Disclosure amendments

A number of corrections and clarifications were made to the disclosures in the notes to the financial statements.

### Full list of amendments to the statements since the Audit and Governance Committee meeting

As agreed at the meeting on 20 July 2018, other minor amendments have been made to the financial statements with the agreement of the Head of Financial Management and the Chair after this date, and prior to the issue of the auditor's report. These reflect relatively minor matters that have been amended arising from the final work undertaken by the audit team. No significant issues requiring amendment were identified by the auditor in this period.

The further minor amendments were:

- cash flow statement – an adjustment of £1,649k to both the operating activities line and investing activities line, which had a neutral effect on the overall statement, and a consequential impact on note 24 on cash flow statement – investing activities; these changes were also reflected in the group cash flow statement
- note 3, critical judgements in applying accounting policies and note 45, financial guarantees to better reflect the nature of pension guarantees
- note 16, financial instruments - adjustment of £10k (reclassification between lines in the note on IAMP LLP loan notes)
- note 33, external audit costs – corrected 'other services' fees from £12k to £17k
- note 36, related parties, a note was added in relation to Sunderland Live Limited which was wound up from 31 March 2017
- note 46 on contingent assets – the note was amended following further consideration by officers

# Appendix B

## Independent auditor's report to the members of Sunderland City Council

### Opinion on the financial statements

We have audited the financial statements of Sunderland City Council for the year ended 31 March 2018 under the Local Audit and Accountability Act 2014. The financial statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement, the Collection Fund Account, the Group Movement in Reserves Statement, the Group Comprehensive Income and Expenditure Statement, the Group Balance Sheet, the Group Cash Flow Statement and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.

In our opinion, the financial statements:

- give a true and fair view of the state of the financial position of Sunderland City Council and its Group as at 31 March 2018 and of the Council's and the Group's expenditure and income for the year then ended; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities section of our report. We are independent of the Council in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Executive Director of Corporate Services' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Executive Director of Corporate Services has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Council's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

### Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) we identified, including those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.



Key audit matter	Our response and key observations
<p><b>Property, plant and equipment valuations</b></p> <p>The financial statements contain material entries on the Balance Sheet as well as material disclosure notes in relation to the Council's holding of PPE.</p> <p>Although the Council employs a valuation expert to provide information on valuations, there remains a high degree of estimation uncertainty associated with the revaluation of PPE due to the significant judgements and number of variables involved in providing revaluations.</p> <p><i>Group audit – PPE valuations was also a Key Audit Matter for the Group audit, although most of the other components do not hold such assets.</i></p>	<p>We considered the Council's arrangements for ensuring that PPE values were reasonable and engaged our own expert to provide data to assist us in assessing the reasonableness of the valuations provided by the Council's valuer.</p> <p>We also assessed the competence, skills and experience of the valuer.</p> <p>We performed further audit procedures on individual assets to ensure that the basis and level of revaluation was appropriate.</p> <p>There were no significant issues arising from our work.</p>
<p><b>Defined benefit liability valuation</b></p> <p>The financial statements contain material pension entries in respect of retirement benefits. The calculation of these pension figures, both assets and liabilities, can be subject to significant volatility and includes estimates based upon a complex interaction of actuarial assumptions. This results in an increased risk of material misstatement.</p> <p><i>Group audit – Defined benefit liability valuation was also a Key Audit Matter for the Group audit.</i></p>	<p>We discussed with officers any significant changes to the pension estimates. In addition to carrying out analytical procedures on the pension disclosures and obtaining a letter of assurance from the auditor of Tyne and Wear Pension Fund, we evaluated the management controls you have in place to assess the reasonableness of the figures provided by the Actuary and considered the reasonableness of the Actuary's output, referring to an expert's report on all actuaries nationally which is commissioned annually by National Audit Office.</p> <p>There were no significant issues arising from our work.</p>

**Our application of materiality**

We apply the concept of materiality both in planning and performing our audit, and in evaluating the effect of misstatements on the financial statements and our audit. Materiality is used so we can plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free from material misstatement. The level of materiality we set is based on our assessment of the magnitude of misstatements that individually or in aggregate, could reasonably be expected to have influence on the economic decisions the users of the financial statements may take based on the information included in the financial statements.

Based on our professional judgement, we determined materiality for Sunderland City Council and its Group for the financial statements as a whole as follows:

	Council	Group
Overall materiality	£11,906k	£12,577k  We set component materiality of the significant component, Together for Children Sunderland Limited, as £1,878k for the purposes of the Group audit.  All other components were audited to local statutory audit materiality, between £60k and £666k, being all below Group financial statement materiality. One component, Sunderland Homes Limited, was exempt from audit.
Basis for determining materiality	approximately 2% of operating expenses of continuing operations	approximately 2% of operating expenses of continuing operations
Rationale for benchmark applied	Operating expenses of continuing operations was chosen as the appropriate benchmark for overall materiality as this is a key measure of financial performance for users of the financial statements.	Operating expenses of continuing operations was chosen as the appropriate benchmark for overall materiality as this is a key measure of financial performance for users of the financial statements.
Performance materiality (Note 1)	£9,525k	£10,061k
Trivial level (Note 2)	£357k	£377k
Specific materiality	Officers remuneration – included in the correct banding Senior officers emoluments – only rounding errors accepted Members allowances £50k Termination benefits £250k	Officers remuneration – included in the correct banding Termination benefits £250k

Note 1 – Performance materiality: This is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole.

Note 2 – Trivial level: This is the level under which individual errors are not communicated to the Audit and Governance Committee. It is based on 3% of overall materiality.

### **An overview of the scope of our audit**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Council's and its Group's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the Executive Director of Corporate Services and the overall presentation of the financial statements. The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are discussed in the "Key audit matters" section of this report. In addition we read all the financial and non-financial information in the Statement of Accounts to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Our Group audit work was based on our assessment of the risk of material misstatement and the materiality of each component. Where other auditors carried out the statutory audit of other entities in the Group, we carried out appropriate procedures in relation to each component auditor's work sufficient to provide the assurance needed for Group audit purposes.

	Full scope audit: Sunderland City Council	Full scope audit: Together for Children Sunderland Ltd	Limited scope audit: Sunderland Care and Support Ltd	Other audit procedures: Other Group Entities
Percentage of Group operating expenses of continuing operations (chosen benchmark for materiality)	77.9%	17%	5%	0.1%
Percentage of Group revenues	80.9%	14%	5%	0.1%
Percentage of Group assets	97.8%	0.1%	0.2%	1.9%

### **Other information**

The Executive Director of Corporate Services is responsible for the other information. The other information comprises the information included in the Statement of Accounts, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

### **Responsibilities of the Executive Director of Corporate Services for the financial statements**

As explained more fully in the Executive Director of Corporate Services' Statement of the Responsibilities for the Statement of Accounts, the Executive Director of Corporate Services is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18, and for being satisfied that they give a true and fair view. The Executive Director of Corporate Services is also responsible for such internal control as the Executive Director of Corporate Services determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Executive Director of Corporate Services is required to comply with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 and prepare the financial statements on a going concern basis, unless the Council is informed of the intention for dissolution without transfer of services or function to another entity. The Executive Director of Corporate Services is responsible for assessing each year whether or not it is appropriate for the Council to prepare its accounts on the going concern basis and disclosing, as applicable, matters related to going concern.

### **Auditor's responsibilities for the audit of the financial statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our auditor's report.

## **Conclusion on Sunderland City Council's arrangements for securing economy, efficiency and effectiveness in the use of resources**

### **Qualified conclusion**

On the basis of our work, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General in November 2017, with the exception of the matter reported in the basis for qualified conclusion paragraph below, we are satisfied that, in all significant respects, Sunderland City Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.

### **Basis for qualified conclusion**

In seeking to satisfy ourselves that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources, we have considered reports issued by other regulators. In July 2015, Ofsted reported the results of an inspection of services for children in need of help and protection, children looked after, care leavers and adoption performance. Ofsted concluded that these services and their leadership, management and governance were inadequate. Ofsted also concluded that the arrangements in place to evaluate the effectiveness of what is done by the Council and its partners to safeguard and promote the welfare of children, through the Sunderland Safeguarding Children Board, were inadequate.

Ofsted published a re-inspection report updating their July 2015 assessment on 25 July 2018. Although some aspects of children's services have improved, the categories of 'children who need help and protection' and 'leadership, management and governance' remain inadequate. Our qualification remains in relation to those services that continue to be assessed as inadequate. This qualification will remain until these services are no longer assessed as inadequate by Ofsted.

We have undertaken our review in accordance with the Code of Audit Practice issued by the Comptroller and Auditor General, having regard to the guidance on the specified criterion issued in November 2017, as to whether the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. The Comptroller and Auditor General determined this criterion as that necessary for us to consider in satisfying ourselves whether the Council put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to form a view on whether, in all significant respects, the Council had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

### **Responsibilities of the Council**

The Council is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

### **Auditor's responsibilities in relation to review of arrangements for securing economy, efficiency and effectiveness in the use of resources**

We are required under section 20(1)(c) of the Local Audit and Accountability Act 2014 to satisfy ourselves that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice requires us to report to you our conclusion relating to proper arrangements. We are not required to consider, nor have we considered, whether all aspects of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

## **Matters on which we are required to report by exception under the Code of Audit Practice**

We are required by the Code of Audit Practice to report to you if:

- we issue a report in the public interest under section 24 of the Local Audit and Accountability Act 2014;
- we make a recommendation under section 24 of the Local Audit and Accountability Act 2014; or
- we exercise any other special powers of the auditor under sections 28, 29 or 31 of the Local Audit and Accountability Act 2014.

We have nothing to report in these respects.

## **Other matters which we are required to address**

The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Council or its Group and we remain independent of the Council and its Group in conducting our audit.

Our audit opinion is consistent with the Audit Completion Report to the Audit and Governance Committee.

## **Use of the audit report**

This report is made solely to the members of Sunderland City Council, as a body, in accordance with part 5 of the Local Audit and Accountability Act 2014 and as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. Our audit work has been undertaken so that we might state to the members of the Council those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the members of the Council, as a body, for our audit work, for this report, or for the opinions we have formed.

## **Delay in certification of completion of the audit**

We cannot formally conclude the audit and issue an audit certificate until we have completed the work necessary to issue our assurance statement in respect of the authority's Whole of Government Accounts consolidation pack. We are satisfied that this work does not have a material effect on the financial statements or on our value for money conclusion.

Mark Kirkham

For and on behalf of Mazars LLP

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31 July 2018