



Audit & Governance Committee  
22 February 2016

**2014/15 Audit Findings Report for Surrey Choices Ltd**

**Purpose of the report:**

The purpose of this report is to share the report of the auditors, Grant Thornton, with the Committee, share background information and a report of the actions being taken in light of the audit report and other matters arising.

This report has been prepared on behalf of the Council's Shareholder Board by the secretary to the Board.

**Recommendations:**

It is recommended that the Committee:

1. Review the report from the auditors, Grant Thornton, and consider the steps being taken to implement improvements, and
2. Determine whether there are any further matters that they wish to draw to the attention of the Council Overview Board, which has the oversight of the Shareholder Board.

**Surrey Choices Ltd**

**Shareholder Board**

1. The Shareholder Board was created following the report to Cabinet in March 2013, which described the Council's strategic approach to innovation and new models of delivery. This strategy set out the Council's approach to continuing to deliver public value in an environment of diminishing financial resources by evaluating different delivery models, including the development of the Council's approach to trading.
2. The Shareholder Board safeguards the Council's interest as shareholder and takes decisions in matters that require the approval of the Council as owner of the company. Decisions in relation to the day to day operation of companies are taken by the directors of each company. The Shareholder Board is comprised of 3 members of the Council's Cabinet and the Chief Executive. The Board is

supported by officers of the Council, including the Section 151 Officer (Director of Finance) and the Monitoring Officer (Director of Legal, Democratic and Cultural Services).

3. The Shareholder Board meets at least quarterly and receives detailed and comprehensive information and briefings to support its decision-making. The extent of the role of the Shareholder Board in decision-making will depend upon the council's shareholding and upon terms included in a company's articles of association, or in the other contractual documents such as a Shareholders' Agreement in relation to Joint-Venture companies.
4. The Council Overview Board has a scrutiny function in relation to the decision-making of the Shareholder Board and in respect of the performance of the companies for which the Council is the majority shareholder.

### **Surrey Choices Ltd**

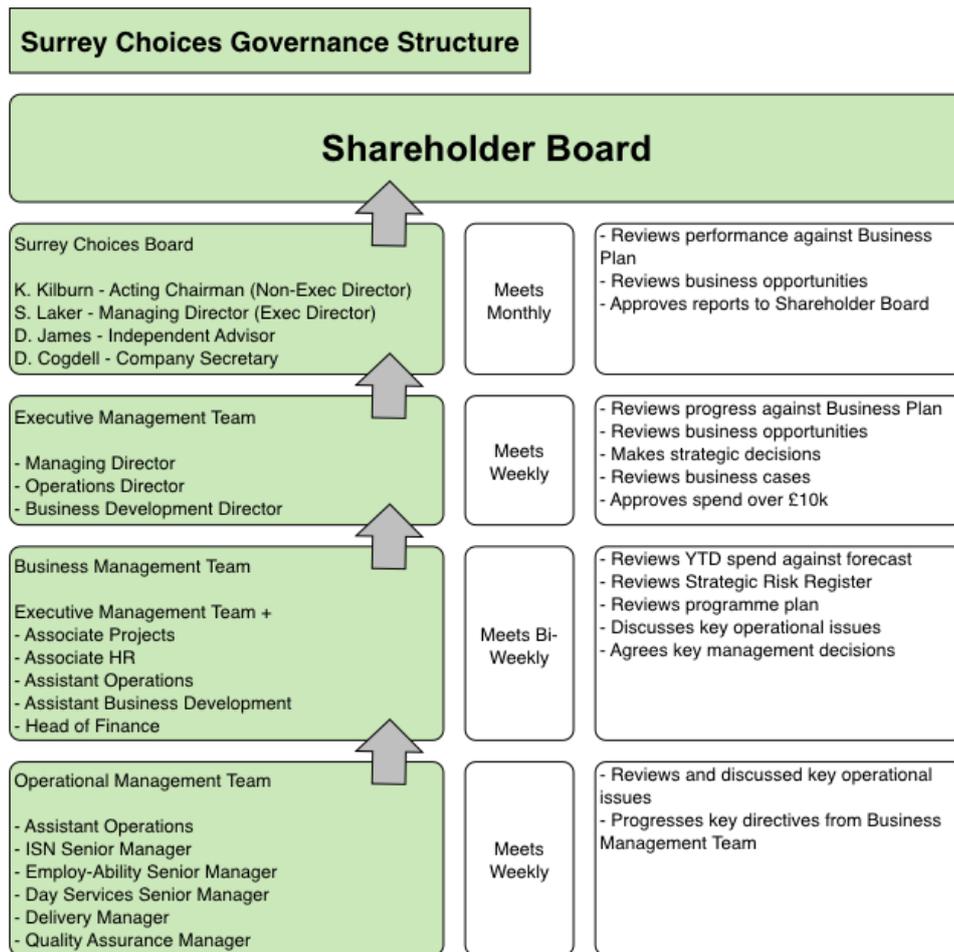
5. Surrey Choices Ltd commenced trading in August 2014, following Cabinet approval of the business case in December 2013. The company provides people with learning and physical disabilities with a range of services in a variety of settings, including day services. The commissioning contract to supply services to the Council is currently based on a "block" arrangement. The contract triggered the transfer of employees from the Council to the company under Transfer of Undertakings (Protection of Employment) Regulations (TUPE).
6. The business case to establish the company expected that the Council would benefit from;
  - Income generated from trading activity by supplying services to those people with personal budgets, and
  - a reduction in the cost of services from reducing fixed costs, and economies of scale delivered as a result of trading activity.
7. The business case demonstrated that the company would make a modest profit within the first five years of operation and that the company would require loans to facilitate the purchase operational assets from the council, pay for set-up costs and to provide for working capital requirements.
8. The Annual Report of the Shareholder Board presented to the Cabinet in July 2015 noted that the Company secured approval from the Care Quality Commission for the regulated services and for the newly developed respite provision. Savings were being made from a reduction in management layers, and services were being reshaped from the customer perspective. The report noted that the financial result for first partial year of trading to 31st March 2015 was a loss which was broadly in line with expectations, excluding the impact of the actuarial review of the pension liability on staff that transferred from the Council. At this time, the company was expecting to be able to achieve a small net profit in the financial year 2015/16.

### **Governance & Controls**

9. The report from the auditors, Grant Thornton, in respect of the financial year ending 31<sup>st</sup> March 2015 is appended to this report. The Committee will note that the auditor highlights significant deficiencies in internal controls. This follows growing concerns expressed by both Internal Audit and the Shareholder Board regarding the robustness of controls and the adequacy of governance arrangements at the company. The background to these concerns is noted below.

10. An Internal Audit review of Surrey Choices Ltd was undertaken in February 2015 in order to provide assurance that effective processes and controls were in place within the company and provided comment on the transition and set-up arrangements. The resultant audit report identified that some improvement was needed – “that a few specific weaknesses were noted; generally the controls evaluated were adequate, appropriate and effective to provide reasonable assurance that risks are being managed and objectives should be met.” The Audit noted that at the time of testing some procedures and policies integral to the company’s governance were yet to be finalised, but that arrangements were in place to demonstrate that they would be addressed in due course. The Auditor commented that the Shareholder Board demonstrated that strategic oversight of the key transitional issues was in place, with appropriate challenge and follow-up of outstanding matters being part of the governance arrangements in place.
11. In July 2015 the Shareholder Board took steps to enhance the governance arrangements for the company and appointed a new Director to the Surrey Choices Board. This followed several months of discussion regarding the need to strengthen the management and therefore the advisors sought an individual who would be able to bring more rigour than had hitherto been in place. The Shareholder Board accepted the resignation of the previous Director of the company, coinciding with changes to the Director’s main employment with the Council.
12. Internal Audit conducted a further audit of Surrey Choices Ltd in August 2015, with the review primarily focusing on the services being delivered by the company to the Council under the agreed contract arrangements. This audit noted that Significant Improvement was needed, that management information provided by the company was inadequate to enable the services (being delivered) to be effectively monitored. The Personalisation Service which the company previously provided has now (from January 2016) been brought back in-house.
13. The Shareholder Board received the audit report from Grant Thornton at its meeting in December 2015. The Board shared its disappointment with the Directors of the company and requested immediate action be taken, particularly in regard to the Chief Financial Officer of the company. The Shareholder Board were very concerned about the failings in the controls and governance of the company, noted that some of the management actions were already underway and that the new Director had injected more rigour to the way in which the company was being managed.
14. The Shareholder Board requested that the company reports progress against the actions on a regular basis and received its first update report at its meeting in February 2016. The Shareholder Board noted that the company has;
  - Established an audit action plan to address each of the areas raised as a concern by Grant Thornton. Progress against this action plan is reviewed weekly by the Managing Director and shared with the auditor.
  - The Managing Director has arranged to hold monthly meetings with the external auditor, who have been asked to –
    - i. Stress-test each area of concern
    - ii. Advise on the reparation and review of the company strategic risk register, incorporating each of the areas of concern
    - iii. Agree a plan with the company to deal with specific issues arising from the previous financial management
    - iv. Attend the wider quarterly managers’ meetings to gain an overview of the company’s quality assurance and control structure.
    - v. Return for a pre-audit, focusing specifically on part-year testing.

- The Directors have made changes to the overarching governance within the company, taking on board advice from the auditors to increase the visibility and collective responsibility of the company's financial performance. This includes the creation of a new business management team designed to provide challenge and scrutiny.



15. The Shareholder Board is encouraged by the steps being put in place to improve the control and governance arrangements and will continue to monitor progress against the agreed actions noted above and the audit action plan on a quarterly basis for the remainder of this year.

### **Financial Results**

16. The Annual Report of the Shareholder Board presented to the Cabinet in July 2015 (and reviewed by the Overview and Scrutiny Board in October 2015) noted that Surrey Choices Ltd was expecting to be able to achieve a small net profit for the current financial year, 2015/16.
17. The Shareholder Board requested and reviewed an update to the financial forecasts of the company at their meeting in December 2015. This forecast however indicated that the company was expecting to report a significant loss, of £1.7m.
18. The Shareholder Board requested that the company provides a revised set of management accounts, providing more detail and setting out the financial position for the next 18 months, the causes of the variances, and the management actions that will be taken. Advice was provided to the Directors to

encourage them to ensure that the company had the right back-office support, and that there was capacity and capability in the top team to be able to provide sufficient support to manage the business and to exploit future growth prospects.

- 19. The Shareholder Board received an update at its meeting in February 2016 and noted that the key reason for the worsening financial situation was the large increase in the services provided by the company due to the volume of referrals (257 new cases) under the block contract arrangements. The Shareholder Board is satisfied that these cases would have created a volume pressure within the Council under previous arrangements and that the company is providing these additional services at a lower cost compared to the previous in-house provision. Discussions have commenced between the company and the Adult Social Care (ASC) Commissioners to agree appropriate actions and adjustments to the contractual relationship to reflect this situation.
- 20. The Shareholder Board is sufficiently encouraged by the progress made by the Directors to believe that a credible recovery plan is achievable to return to profitability. The company will commence actions and further develop its financial plans which will be presented as the Annual Business Plan of the company to the Shareholder Board in March 2016.

**Implications:**

**Financial and value for money implications**

- 3. As highlighted above, one of the key drivers behind the deteriorating financial situation of the company has been the increase in volumes of cases referred by the Council and supported by Surrey Choices Ltd. Discussions are underway between the company and ASC commissioning officers to agree appropriate adjustments to the block contract. These discussions will seek to achieve the most affordable outcome for the Council without further detriment to its group company.
- 4. The Council may consider providing a further working capital loan facility to Surrey Choices Ltd. In order to agree and recommend this to the Council, the Shareholder Board will expect to see that the loan can be repaid, that the company can demonstrate a return to profitability, and be reassured that the control and governance environment within the company has been significantly improved.

**Equalities and Diversity Implications**

- 5. There are no direct equalities implications but any actions taken need to be consistent with the Council's policies and procedures.

**Risk Management Implications**

- 6. Improvements to the effective management of risks and implementation of robust financial controls will support the company and therefore the Council to meet its objectives and enable value for money.

**Next steps:**

The Shareholder Board will receive regular progress reports from the Directors of Surrey Choices, including an Annual Business Plan, which is expected to demonstrate the ability of the company to return to profitability within an acceptable

timeframe. The Shareholder Board will receive regular reports in respect of the control & governance improvements required and being implemented by the company.

The council's Internal Audit department will be invited to review the progress being made to improve the governance and control environment of the company.

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