The Audit Findings for Surrey Choices Limited

31 March 2015

December 2015

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December 2015

Dear Sirs

Audit Findings for Surrey Choices Limited for the period ended 31 March 2015

This Audit Findings report highlights the significant findings arising from the audit for the benefit of those charged with governance, as required by International Standard on Auditing (UK & Ireland) 260. Its contents have been discussed with management.

As auditors we are responsible for performing the audit, in accordance with International Standards on Auditing (UK & Ireland), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

We would like to take this opportunity to record our appreciation for the kind assistance provided by the finance team and other staff during our audit.

Yours faithfully

Richard Hagley

Contents

Section 1: Status of the audit and audit opinion

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Status of the audit and audit opinion

Our work is substantially complete and there are currently no matters of which we are aware which would require modification of our audit opinion.

●	Our anticipated audit report will be unmodified

Section 2: Executive summary

Executive Summary

Key issues arising from our audit

Financial statements opinion

We anticipate providing an unqualified opinion in respect of the financial statements.

The key messages arising from our audit of the company's financial statements are that the company:

- produced draft financial statements for its first period of trading in accordance with the planned audit timetable and in time for inclusion in the consolidated accounts of the company's parent, Surrey County Council
- implemented a full general ledger system, BluQube, from February 2015 and began to develop and action some clearly defined month-end processes
- audit working papers as requested in the 'working paper requirements' document shared with the company were not provided at the start of the audit fieldwork – this caused a delay in some fieldwork being commenced
- the financial statements had to go through a number of iterations, with significant extra effort required to reach an acceptable standard
- the response time to audit queries was in many cases beyond the agreed timeframe and this meant that the completion of audit fieldwork was delayed significantly beyond the period of our onsite visit

We have identified a series of adjustments to the draft financial statements (details are recorded in section eight of this report). The draft financial statements for the period ended 31 March 2015 recorded a loss of £480,289. The equivalent figure per the audited financial statements is £666,764. The adjustments predominantly relate to:

- Year-end pay costs not accrued for in the draft financial statements
- Removal of an incorrect accrual for VAT on property rent
- Capitalisation and depreciation of a number of items that had previously been expensed
- Creditors not included in the draft financial statements
- Reclassification of a loan held with Surrey County Council
- Deferred tax not included in the draft financial statements
- IAS 19 costs not included in the draft financial statements and correction of the defined benefit pension scheme liability

In addition, we identified expenditure that related to 14/15 but which had not been accrued for, as well as debtors that had been incorrectly accounted for. Management have decided not to correct for either of these, which are immaterial to the financial statements. We have also agreed with management a number of amendments to the notes to the financial statements.
Further details are provided in sections five and eight of this report.

Controls

Roles and responsibilities

The company's management is responsible for the identification, assessment, management and monitoring of risk, and for developing, operating and monitoring the system of internal control.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we report these to the company.

Findings

We draw your attention in particular to control issues identified in relation to journals, debtors, payroll, petty cash and accruals.
Further details are provided within section seven of this report.

The way forward

Matters arising from the financial statements audit have been discussed with the Chief Finance Officer. As a result, we have made a number of recommendations, which are set out in the action plan in Appendix A. Recommendations have been discussed and agreed with the Chief Finance Officer and the finance team.

Looking ahead, the company are required to present accounts under the new FRS 102 accounting framework in 2015/16. It is important this is planned thoroughly and considered sufficiently early. We will support the company in this process and work closely with the finance team to ensure working paper requirements can be met and that audit query response times are achievable.

Section 3: Overview of audit findings

Overview of audit findings

Account	Material misstatement risk?	Description of risk	Changes to Audit Plan?	Sufficiency of controls?	Significant audit findings?
Trade debtors	Reasonably Possible	Contract accounting not consistent with terms	No	●	Yes
Cash	Remote	-	No	●	None
Trade creditors	Reasonably Possible	Creditors understated or not recorded in correct period	No	●	Yes
Defined pension scheme liability	Remote	-	No	●	Yes
Equity	-	-	-	●	-
Reserves	Remote	-	No	●	Yes

Account	Material misstatement risk?	Description of risk	Changes to Audit Plan?	Sufficiency of controls?	Significant audit findings?
Revenue	Significant	Contract accounting not consistent with terms	No	●	None
Payroll	Reasonably Possible	Employee remuneration and benefit obligations and expenses understated	No	●	Yes
Other operating expenses	Reasonably Possible	Creditors understated or not recorded in correct period	No	●	Yes
Administrative expenses	Reasonably Possible	Creditors understated or not recorded in correct period	No	●	Yes
Exceptional items	Reasonably Possible	Creditors understated or not recorded in correct period	No	●	None
Taxation	-	-	-	●	-

Changes to Audit Plan

- We have not had to alter or change our Audit Plan as previously communicated to you on 12 August 2015.

Controls

- Deficiencies in controls over cash, payroll, debtors and creditors have been identified. Further details are provided in section seven of this report.

Controls

For further details see Internal controls

- ● Significant deficiency
- ● Deficiency
- ● No findings
- ● Controls not evaluated under Audit Plan

Section 4: Significant findings

Significant findings

	Risks identified in our audit plan	Commentary
1.	**Improper revenue recognition** • Under ISA 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue	• We undertook the following procedures in response to this risk: – documentation of our understanding of management's controls over revenue recognition – review and testing of revenue recognition policies – testing of material revenue streams including significant income contracts Our audit work has identified no issues in respect of revenue recognition.
2.	**Management override of controls** • Under ISA 240 there is a presumed risk that the risk of management over-ride of controls is present in all entities	• We undertook the following procedures in response to this risk: – review of accounting estimates, judgements and decisions made by management – review of unusual significant transactions Our audit work has not identified any evidence of management override of controls.

Section 5: Other findings

Other findings

	Risks identified in our audit plan	Work completed	Issues arising
1.	**Revenue and debtors** • Contract accounting not consistent with terms	• Walkthrough of arrangements for accounting for contract arrangements • Review of significant income contracts • Agreement of significant income to contracts • Review of significant contract arrangements to ensure they were accounted for correctly at year end • Review and testing of other income where significant to ensure in line with terms	We have identified no issues in relation to this risk we are required to report to you.
2.	**Operating expenses and trade creditors** • Creditors understated or not recorded in correct period	• Walkthrough of the operating expenses system • Sample testing of in-year expenditure • Completeness testing of expenditure and year end payables	Our audit work has identified a series of non-trivial amendments to cost of sales, administrative expenses and interest payable. The majority of these relate to reclassification of expenditure, whilst the remainder relate to inclusion of IAS 19 costs, accrual of previously unaccrued expenditure and capitalisation of some items of expenditure. Further details are provided on pages 23-24. There are no other issues in relation to this risk we are required to report to you.
3.	**Payroll** • Employee remuneration and benefit obligations and expenses understated	• Walkthrough of payroll arrangements • Review of work performed over the payroll system by the Surrey County Council audit team • Completeness testing of payroll records • Testing of payroll transactions to supporting records • Reconciliation of payroll records	Our audit work has identified four non-trivial amendments to payroll expenditure. Of these, three have a net impact on the face of the financial statements, with an aggregate impact of £362,097. The remaining amount has only a disclosure impact of £201,644, with these costs having previously been reflected in the financial statements but not the disclosure. Further details are provided on pages 23-24. There are no other issues in relation to this risk we are required to report to you.

Other findings – disclosures

	Adjustment type	Account balance	Impact on the financial statements
1.	Disclosure	Note 5 – Particulars of employees	This disclosure has been updated to reflect the additional accrued £216,097 NIC and PAYE costs, the £184,000 IAS 19 employer contributions adjustment and the £330,000 IAS 19 costs in the adjusted financial statements, as detailed on pages 8 and 23. In addition, there was £201,644 of wages, salaries and social security costs included in the draft profit and loss account but not included in the draft version of this note. This disclosure error has also been amended by management.
2.	Disclosure	Note 6 – Directors' remuneration	This note has been updated for the correct remuneration figure and to include the company pension contribution figure.
3.	Disclosure	Note 7 - Taxation	This note was not included in the draft financial statements.
4.	Disclosure	Note 10 – Creditors: amounts falling due within one year	This disclosure has been updated to reflect: • £273,172 being reclassified as a trade creditor from amounts owed to group undertakings • Interest payable being removed from amounts owed to group undertakings to a separate category • Other creditors being adjusted for the £153,084 VAT and £216,097 NIC and PAYE costs as detailed on page 23 • £1,365,000 in respect of a loan held with Surrey County Council has been reclassified as a non-current creditor as the agreement terms state repayment is due by June 2019.
5.	Disclosure	Note 12 – Deferred tax	This note was not included in the draft financial statements.
6.	Disclosure	Note 15 – Reconciliation of movement in shareholders' funds	This note was not included in the draft financial statements.

Other findings – disclosures (continued)

	Adjustment type	Account balance	Impact on the financial statements
7.	Disclosure	Note 16 – Defined benefit pension scheme	This note has been expanded to incorporate: • Details of the assets and liabilities as at 18 August 2014 • Reconciliation of the opening and closing fair values of the scheme assets and opening and closing defined benefit obligations • Fair values of the scheme assets by asset category • Key assumptions employed by the actuary
8.	Disclosure	Note 17 – Operating lease commitments	This note was not included in the draft financial statements.

Section 6: Other communication requirements

Other communication requirements

	Issue	Commentary
1.	**Matters in relation to fraud**	• We have previously discussed the risk of fraud with management. We have not been made aware of any incidents in the period and no other issues have been identified during the course of our audit procedures
2.	**Matters in relation to related parties**	• We are not aware of any related party transactions which have not been disclosed
3.	**Matters in relation to laws and regulations**	• We are not aware of any significant incidences of non-compliance with relevant laws and regulations
4.	**Written representations**	• A letter of representation has been requested from the Company, including a summary of unadjusted misstatements and additional representations in respect of the net deferred tax asset and opening defined benefit pension scheme liability in the adjusted financial statements
5.	**Confirmation requests from third parties**	• We requested from management permission to send a confirmation request to the Company's bank. This permission was granted and the requests were sent. This was returned with positive confirmation
6.	**Disclosures**	• Our review found no material omissions in the financial statements

Section 7: Internal controls

Internal controls

Assessment
- Significant deficiency – risk of significant misstatement
- Deficiency – risk of inconsequential misstatement

- The purpose of an audit is to express an opinion on the financial statements.
- Our audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control
- The matters being reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with ISA 265
- If we had performed more extensive procedures on internal control, we might have identified more deficiencies to be reported

	Assessment	Issue and risk	Recommendations
1.	Significant deficiency – risk of significant misstatement	• Our testing of payroll expenditure identified a number of individuals for whom the company did not hold contracts of employment. It has been explained that: (i) For staff transferred from Surrey County Council, contract files have not yet been released by the Council (ii) For joiners to the company post-transfer, employment contracts have not yet been signed (iii) For Senior Management, the employment contracts have not yet been signed If signed contracts are not held by the company there is a risk of non-compliance with the requirements of the company's regulator, the Care Quality Commission. There is also a contractual risk in the event of disputes with employees.	• The company should ensure processes for obtaining and signing employee contracts are completed as soon as possible. **Management response** • (i) We accept the findings of the report. We had identified this issue in July 2015 and have contacted Surrey County Council to ask for the files to retrieved and passed to us as soon as possible. • (ii) We accept the findings of the report. New contracts of employment have now been drafted and we expect all staff to have signed their contract by 31 March 2016. • We accept the findings of the report. Contracts of employment for senior managers have been drafted and we expect all senior managers to have signed their contract by 31 March 2016.
2.	Significant deficiency – risk of significant misstatement	• Testing of journals identified a number of weaknesses around journals processes. Specifically, there are no set limits in the system for journals posting, segregation of duties between journal preparer and poster have not always been followed and there is no evidence of journals authorisation have taken place. We recognise that the general ledger does limit the access to post journals to the financial controller only. There is a risk that inappropriate or inaccurate journals are posted to the general ledger.	• Processes should be put in place to ensure that: (i) There is segregation of duties between poster and preparer (ii) Journals authorisation is formally evidenced, either within BluQube or by some other means (iii) There are journals posting limits set for different members of staff **Management response** • We accept the findings of the report. New sign off processes and limits are currently being developed and we would expect them to be in place, including a retrospective review of all journals by 31 January 2016.

Internal controls (continued)

	Assessment	Issue and risk	Recommendations
3.	Deficiency - risk of inconsequential misstatement	• Our testing of creditors identified a small number of invoices that related to 2014-15 but that were not included in the year-end creditors balance (further details are provided in section eight of this report). This was due mainly to late receipt of invoices from some of the business units and, as a result, a lack of timely review by the finance team. There is a risk that creditors are understated in the financial statements and in-year management accounts.	• The company should ensure processes are put in place to review invoices received post month-end, and that business units are aware of the timetable to submit invoices to the finance team. **Management response** • We accept the findings of the report in regard to the former manual accounting processes. Our bluQube processes are currently being reviewed to ensure all costs and liabilities are identified and that creditors are correctly stated.
4.	Deficiency - risk of inconsequential misstatement	• There was a difference of £777 identified when the petty cash balances were reconciled to the accounts, which the financial controller undertook during the audit. There is no formal process in place to reconcile the petty cash balances at year-end. There is a risk that cash balances are not accurately stated in the company's assets and, if not regularly reconciled, that assets are misappropriated.	• Processes should be put in place to ensure all petty cash balances are accurately reconciled on a regular basis. **Management response** • We accept the findings of the report. New processes are now in place to ensure petty cash is regularly reconciled as part of month end processes. We will also include a specific section on control of both petty cash and purchasing cards in our Quality Checking process.
5.	Deficiency - risk of inconsequential misstatement	• There were a number of income balances due from Surrey County Council for which no supporting invoices were raised. This is due to the Council being viewed as an internal department for which, per company policy, no invoices are raised. There is a risk that this could put the company at risk of challenge from the Council over amounts due.	• Going forward, invoices should be raised for amounts due from Surrey County Council. **Management response** • We accept the findings of the report. This was a particular issue relating to additional funding for EmployAbility activity. This is no longer the case as all revenues are invoiced.

Assessment
- Significant deficiency – risk of significant misstatement
- Deficiency – risk of inconsequential misstatement

Section 8: Misstatements

Adjusted misstatements

Detail	Profit and loss account (£) Debit	Profit and loss account (£) Credit	Balance sheet (£) Debit	Balance sheet (£) Credit	Profit effect (£)
Loss per draft accounts					**(480,289)**
Cost of sales	216,097				(216,097)
Creditors				216,097	-
NIC and PAYE creditors had not been accrued for at year-end					
Creditors			153,084		-
Cost of sales		153,084			153,084
The draft accounts incorrectly included a VAT accrual on property rent					
Interest payable & similar charges	22,234				(22,234)
Administrative expenses		22,234			22,234
Interest payable on a loan from Surrey County Council was not correctly classified on the profit and loss account					
Administrative expenses	10,000				(10,000)
Creditors				10,000	-
The draft accounts did not include an accrual for the external audit fee					
Tangible fixed assets			116,092		-
Cost of sales	10,541				(10,541)
Administrative expenses		114,089			114,089
Cost of sales		12,544			12,544
In the draft accounts there was computer equipment and property which should have been capitalised and depreciated that had been expensed					
Creditors: amounts falling due more than one year				1,365,000	-
Creditors: amounts falling due within one year			1,365,000		-
A loan held with Surrey County Council not due for repayment until June 2019 was reclassified on the balance sheet					
Cost of sales	330,000				(330,000)
Other finance costs	27,000				(27,000)
Employer pension contributions		184,000			184,000
Defined benefit pension scheme liability			184,000		-
Reserves				357,000	-
IAS 19 costs had been accounted for incorrectly in the draft financial statements					

Adjusted misstatements (continued)

Detail	Profit and loss account (£) Debit	Profit and loss account (£) Credit	Balance sheet (£) Debit	Balance sheet (£) Credit	Profit effect (£)
Loss per draft accounts					**(480,289)**
Debtors			16,046		-
Tax on loss on ordinary activities	56,554				(56,554)
Deferred tax liability on defined benefit pension scheme deficit		72,600			-
Deferred tax was not included in the draft financial statements					
Defined benefit pension scheme liability			1,037,000		-
Reserves				1,037,000	-
The draft financial statements incorrectly included a historic liability in respect of the defined benefit pension scheme					
Loss per final accounts	672,426	558,551	2,871,222	2,985,097	**(666,764)**

Unadjusted misstatements

Detail	Profit and loss account Debit	Profit and loss account Credit	Balance sheet Debit	Balance sheet Credit	Profit effect	Reason for not adjusting
Loss per final accounts					**(666,764)**	
Cost of sales	19,179				(19,179)	
Creditors				19,179	-	
Being accrual of costs relating to 14/15 for which invoices were received post year-end						**Amount is immaterial**
Turnover	38,960				(38,960)	
Debtors				38,960	-	
Being inclusion of an amount in debtors that should have been removed						**Amount is immaterial**
Potential Loss	58,139	-	-	58,139	**(724,903)**	

Section 9: Fees, non audit services and independence

Fess, non audit services and independence

	Planned Fee (£)	Actual fee (£)	Threat Y/N	Safeguard
Audit	9,000	TBC*	N	n/a
Other	Nil	Nil	n/a	n/a

Independence and ethics:

- We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements
- We confirm that we have implemented policies and procedures to meet the requirement of the Auditing Practices Board's Ethical Standards

* as a result of the issues encountered during the audit (and as explained in section two of this report) we will be agreeing additional fees with the Chief Finance Officer.

Section 10: Communication of audit matters

Communication of audit matters with those charged with governance

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	✓	
Overview of the planned scope and timing of the audit. Form, timing and expected general content of communications	✓	
Views about the qualitative aspects of the Company accounting and financial reporting practices, significant matters and issue arising during the audit and written representations that have been sought		✓
Confirmation of independence and objectivity	✓	✓
A statement that we have complied with relevant ethical requirements regarding independence. Relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence		✓
Material weaknesses in internal control identified during the audit		✓
Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements		✓
Non compliance with laws and regulations		✓
Expected modifications to the auditor's report, or emphasis of matter		✓
Uncorrected misstatements		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to Going Concern		✓

International Standards on Auditing (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table here.

This document, The Audit Findings, outlines those key issues and other matters arising from the audit, which we consider should be communicated in writing rather than orally, together with an explanation as to how these have been resolved.

Distribution of this Audit Findings report

Whilst we seek to ensure our audit findings are distributed to those individuals charged with governance, as a minimum a requirement exists for our findings to be distributed to all the company directors and those members of senior management with significant operational and strategic responsibilities. We are grateful for your specific consideration and onward distribution of our report, to those charged with governance

Respective responsibilities

As auditor we are responsible for performing the audit in accordance with ISA's (UK and Ireland), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance.

The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

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Appendices

Appendix A: Action plan

The following recommendations have been agreed with management:

Rec No.	Recommendations for 2015/16	Priority	Management response	Implementation date & responsibility
1	Compile working papers for the start of the audit that include transaction-level or equivalent listings supporting every balance in the financial statements	High	We agree with the recommendation in the report. The implementation of bluQube will help this area substantially. We would expect this to be in place for the preparation of the financial statements to the period ended 31 March 2016. However, we would also propose Surrey Choices and Grant Thornton undertake collaborative work, especially in planning of the audit. Changes to personnel and the extended gap between audit planning and fieldwork meant that some disruption occurred from our perspective, with some information requests being repeated. This led to confusion both in the finance team in Surrey Choices and the audit team in Grant Thornton and contributed to some of the issues highlighted in your report. Whilst this is by no means a significant issue, we believe there is scope to improve our joint working, making both the work of both client and auditor more efficient and effective.	Chief Finance Officer, 31 March 2016
2	Ensure the 2015/16 accounts are prepared in accordance with the requirements of FRS 102 before submission for audit	High	We accept the recommendation in the report. Whilst our financial statements for the period ended 31 March 2015 were appropriately prepared using FRS 3, as mentioned above we believe that some of the adjustments were both a normal part of a year end review and that others especially relating to the application pension liabilities, proved so technically challenging that even experts within Grant Thornton struggled to provide the correct advice first time. Therefore, it is an unreasonable expectation that the financial statements will be perfect prior to audit. We agree that we can improve our readiness, (regardless of the accounting standard in operation), and that this can be achieved through improved planning as identified above. We acknowledge that for the period ended 31 March 2016 is past the trigger date for FRS 102 and we are training our staff in the use of FRS 102 in preparing our financial statements.	Chief Finance Officer, 31 March 2016

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