

The Annual Audit Letter for Surrey County Council

Year ended 31 March 2016

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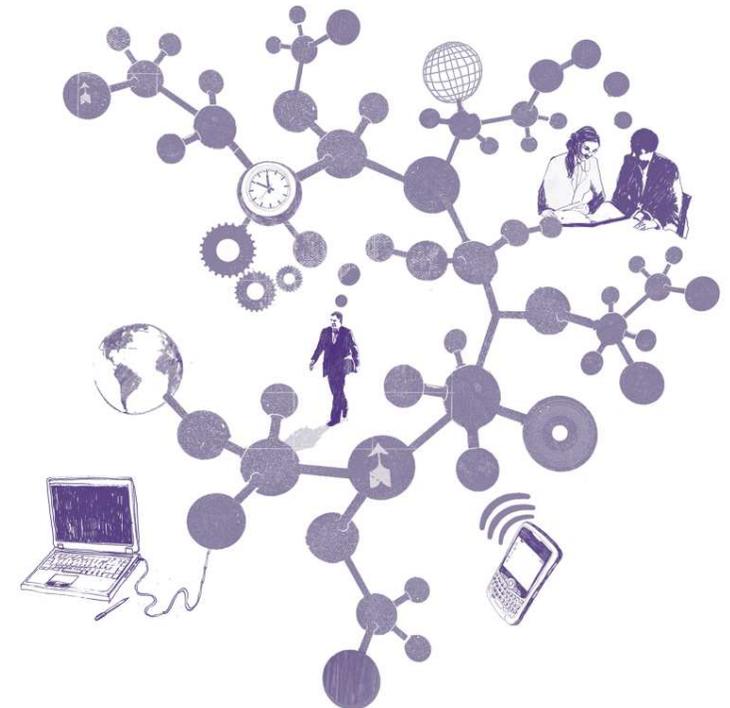
September 2016

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Executive summary

Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Surrey County Council (the Council) for the year ended 31 March 2016.

This Letter is intended to provide a commentary on the results of our work to the Council and its 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 (the Code) and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'.

We reported the detailed findings from our audit work to the Council's Audit and Governance Committee as those charged with governance in our Audit Findings Report on 25 July 2016.

Our responsibilities

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

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

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

Our work

Financial statements opinion

We gave an unqualified opinion on the Council's financial statements on 27 July 2016.

Value for money conclusion

We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources during the year ended 31 March 2016 except for the matters arising from Ofsted's inspection report on children's services in 2014/15. The Council is working hard to address the issues raised by Ofsted. Until such time as Ofsted confirm it is satisfied with progress, the qualification remains in place. We therefore qualified our value for money conclusion in our audit opinion on 27 July 2016.

Use of additional powers and duties

We have not identified any issues that have required us to apply our statutory powers and duties under the Local Audit and Accountability Act 2014.

Whole of government accounts

We completed work on the Council/Authority's consolidation return following guidance issued by the NAO and issued an unqualified report.

Certificate

We are currently unable to certify that we have completed the audit of the accounts of Surrey County Council as we have not yet completed the work required under the Code on giving an audit opinion on the pension fund annual report. We are liaising closely with the pensions team to conclude this area of our work.

Certification of grants

We also carry out work to certify the Council's Teachers' Pensions return. Our work on this claim is not yet complete and will be finalised by 30 November 2016 and we will report the results of this work to the Council.

Other work completed

We have also worked with the Council as auditor of its three subsidiary trading companies. We have reported back findings for S.E. Business Services and Surrey Choices and will do so also for Halsey Garton Property. In particular, we have invested significant time in regular liaison with Surrey Choices officers to ensure the necessary improvements in internal control, governance and financial management have been made since 2014/15. We will formally report on the outcome of this process on conclusion of the 2015/16 audit of Surrey Choices in early October 2016.

Working with the Council

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

Grant Thornton UK LLP
September 2016

Audit of the accounts

Our audit approach

Materiality

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

We determined materiality for our audit of the Council's accounts to be £27,787k (being 1.5% of prior year audited gross revenue expenditure). We used this benchmark, as in our view, users of the Council's accounts are most interested in how it has spent the income it has raised from taxation and grants during the year. We also set a lower level of specific materiality for certain areas such as cash, senior officer remuneration and disclosure of related party transactions.

Pension Fund

For the audit of the Surrey Pension Fund accounts, we determined materiality to be £31,236k (being 1% of net assets from the year audited accounts). We used this benchmark, as in our view, users of the Pension Fund accounts are most interested in the value of assets available to fund pension benefits. We set a lower level of specific materiality for certain areas such as related party transactions and cash.

The scope of our audit

Our audit involves obtaining enough 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 Council's accounting policies are appropriate, have been consistently applied and adequately disclosed;
- 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 narrative report and annual governance statement to check they are consistent with our understanding of the Council and with the accounts on which we give our opinion.

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

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

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

Audit of the accounts - Council

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
<p>Valuation of property, plant and equipment The Council revalues its assets on a rolling basis over a five year period. The Code requires that the Council ensures that the carrying value at the balance sheet date is not materially different from current value. This represents a significant estimate by management in the financial statements.</p>	<ul style="list-style-type: none"> • Review of management's processes and assumptions for the calculation of the estimate. • Review of the competence, expertise and objectivity of any management experts used. • Review of the instructions issued to valuation experts and the scope of their work. • Discussions with the Council's valuer about the basis on which the valuation was carried out, challenging the key assumptions. • Review and challenge of the information used by the valuer to ensure it was robust and consistent with our understanding. • Testing of revaluations made during the year to ensure they were input correctly into the Council's asset register and financial statements. • Procedures to confirm the reasonableness of the revaluations, including reference to national trends where appropriate. • Evaluation of the assumptions made by management for those assets not revalued during the year and how management satisfied themselves that these were not materially different to current value. <p>Our audit work did not identify any material issues in respect of the risk identified.</p>
<p>Valuation of pension fund net liability The Council's pension fund asset and liability as reflected in its balance sheet represent significant estimates in the financial statements.</p>	<ul style="list-style-type: none"> • Identification of the controls put in place by management to ensure that the pension fund liability is not materially misstated. Assessment of whether these controls were implemented as expected and whether they were sufficient to mitigate the risk of material misstatement. • Review of the competence, expertise and objectivity of the actuary who carried out your pension fund valuation. Confirmed our understanding of the basis on which the valuation is carried out. • Procedures to confirm the reasonableness of the actuarial assumptions made. • Review of the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial report from your actuary. <p>Our audit work did not identify any material issues in respect of the risk identified.</p>

Audit of the accounts – Pension Fund

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

Risks identified in our audit plan	How we responded to the risk
<p>Level 3 Investments – valuation is incorrect Under ISA(UK&I) 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.</p>	<ul style="list-style-type: none">• We gained an understanding of the transaction including a review of supporting documentation.• We considered and documented management's controls over the valuation of these investments.• We carried out walkthrough tests of the controls identified in the cycle.• Tested a sample of private equity investments by obtaining and reviewing the audited accounts at latest date for individual investments and agreeing these to the fund manager reports at that date. Reconciliation of those values to the values at 31 March with reference to known movements in the intervening period.• Reviewed the qualifications of fund managers as experts to value the level 3 investments at year end and gained an understanding of how the valuation of these investments has been reached.• Reviewed the nature and basis of estimated values and considered what assurance management has over the year end valuations provided for these types of investments.• Reviewed the competence, expertise and objectivity of any management experts used. <p>Our audit work did not identify any material issues in respect of the risk identified.</p>



Audit of the accounts

Audit opinion

We gave an unqualified opinion on the Council's accounts on 27 July 2016, well in advance of the 30 September 2016 national deadline.

The Council made the accounts available for audit in line with the agreed timetable, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit. We reported the key issues from our audit of the accounts of the Council to the Council's Audit and Governance Committee on 25 July 2016.

Pension Fund accounts

We also reported the key issues from our audit of accounts of the Pension Fund hosted by the Council to the Audit and Governance Committee on 25 July 2016.

We recommended that given the potential sensitivity of cash balances, unreconciled differences on cash balances should be fully adjusted on at least an annual basis. Management agreed to ensure that any variances will be fully adjusted as part of a quarterly reconciliation.

Annual Governance Statement and Narrative Report

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

Both documents were prepared in line with the relevant guidance and were materially consistent with the supporting evidence provided by the Council and with our knowledge of the Council.

Whole of Government Accounts (WGA)

We carried out work on the Council's consolidation schedule in line with instructions provided by the NAO. We issued a group assurance certificate which did not identify any issues for the group auditor to consider.

Other statutory duties

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

We have no matters to report.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice (the Code), following the guidance issued by the NAO in November 2015 which specified the criterion for auditors to evaluate:

In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Key findings

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

The key risks we identified and the work we performed are set out in table 2 overleaf.

Overall VfM conclusion

We are satisfied that, in all significant respects, except for the matter we identified below, in respect of Ofsted, the Council had proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2016.

We focused our work on the significant risks that we identified in the Council's arrangements. In arriving at our conclusion, our main considerations were:

- The publication of an inspection report by Ofsted dated 3 June 2015 concluded that the overall arrangements for Children's Services in the Surrey County Council area were judged to be 'inadequate.' This matter is evidence of weaknesses in leadership and proper arrangements for understanding and using appropriate and reliable performance information to support informed decision making and performance management, and for planning, organising and developing the workforce effectively to deliver strategic priorities. The Council has since agreed an Improvement Plan to address the issues highlighted in the report. We note that the Council has considerable corporate ownership of these issues in Children's Services and that improvements are in hand. Ofsted has yet to publish a subsequent inspection report and as such the judgement from June 2015 remains in place.

Value for Money Conclusion (continued)

Table 2: Value for money risks

Risk identified	Work carried out	Findings and conclusions
<p>Financial Health The Council has historically managed its finances well and has consistently achieved savings targets. It is on course to achieve a balanced budget for 2015/16. However, following the most recent settlement, the scale of efficiencies and savings required is sizeable.</p>	<p>We have:</p> <ul style="list-style-type: none"> •reviewed the Council's progress in updating its medium term financial strategy and the reports to members •reviewed the outturn position for 2015/16 and the budget plans for 2016/17 and 2017/18 •met with key officers to discuss key strategic challenges and the Council's proposed response 	<p>The Council has a very good recent history of coping with change in its financial environment, and after successfully completing 2015/16 with a £8.7m underspend, it is preparing its next five-year plan. The Council has set a balanced 2016/17 budget through a mixture of savings and planned use of £25m of reserves. There is an as yet unbridged funding gap rising to £50m by the end of 2018/19, which has arisen as a consequence of a difficult financial settlement from the Government with both reduced funding and some increased costs and burdens anticipated. The Council is continuing to drive transformational change across all departments but recognises that difficult decisions may be unavoidable.</p> <p>The Council continues to demonstrate sound arrangements for sustainable resource deployment in a very challenging external environment.</p>
<p>Orbis partnership The Orbis partnership is now underway. It is both innovative and represents a major change in back office service provision. The partnership is of considerable strategic importance to the Council.</p>	<p>We have:</p> <ul style="list-style-type: none"> •met with officers to understand the nature and extent of progress with the project •reviewed key decision papers and reports presented to Council committees 	<p>Early in 2015 both East Sussex and Surrey County Council Cabinets approved the business case to establish a public sector partnership to create an integrated business services organisation called Orbis, delivering business and support services to both authorities.</p> <p>The Council has invested significantly in the partnership and Orbis now has 1,400 staff and a £53m operating budget.</p> <p>The partnership is aiming to deliver potential savings of 10-15% (£6m-£8m) across both East Sussex and Surrey over a three year period through management delayering, process improvement and reduction of duplication. Orbis is also exploring the possibility of Brighton and Hove City Council joining the partnership. Good progress has been made to date including the appointment of Directors, and the development of the Orbis brand. A risk around licensing arrangements has been identified and a task force established to investigate any potential breach of terms and conditions as a result of working in partnership. Orbis will need to be clear about the impact of utilising software across the partnership when the contract is with only one sovereign organisation. This may require renegotiation of the contract to enable use across the partnership or even re-procurement. Key challenges ahead will include the development of a single culture and the integration of IT and data sharing/confidentiality, as well as licensing agreements.</p> <p>The Council has demonstrated proper arrangements in place for partnership working in respect of Orbis.</p>

Value for Money Conclusion (continued)

Table 2: Value for money risks

Risk identified	Work carried out	Findings and conclusions
<p>Ofsted inspection of children's services Ofsted issued a critical report on children's services in 2014/15 and the Council is currently subject to follow up review. We issued a qualified except for conclusion in 2014/15. Until such time as Ofsted confirm adequate arrangements are in place this remains a significant risk.</p>	<ul style="list-style-type: none"> We have reviewed the Council's progress in addressing Ofsted's recommendations including meeting with key officers, reviewing internal reports and further information from Ofsted as available. 	<p>The Council invited Ofsted to carry out an inspection of its children's services based on the new multiagency framework, following a reorganisation of its children in need teams and the establishment of the referral, assessment and intervention service (RIAS). Ofsted undertook its review in October and November 2014. Its report was published on 3 June 2015 with the overall judgement that children's services are inadequate. It states that 'there are widespread and serious failures that potentially leave children at risk of harm.' The main failing relates to the lack of management oversight of cases which were stepped down, with the risk that children do not receive the services that they need. The Council accepts this finding.</p> <p>An action plan was developed as soon as the inspection had concluded. This was divided into immediate short-term actions to correct failings, and longer-term more sustainable solutions. The Children's Improvement plan was refreshed in February 2016 showing that the Council had made some good progress, changes are underway, there is an understanding of the underlying challenges and that plans are in place to tackle these issues. Challenges for the Council include ensuring that there are sufficient and stable numbers of effective operational staff, reducing a reliance on agency staff which currently runs at 30%, ensuring leadership behaviours consistently promote high quality of practice, and building effective working with partners based on trust and clarity of respective roles and responsibilities. The Council recognises that, whilst it has made progress, there continues to be work required to achieve the consistent level of performance it aspires to.</p> <p>We concluded that there were weaknesses in leadership and in proper arrangements for understanding and using appropriate and reliable performance information to support informed decision making and performance management, and for planning, organising and developing the workforce effectively to deliver strategic priorities.</p>



Working with the Council

Our work with you in 2015/16

We are really pleased to have worked with you over the past year. We have established a positive and constructive relationship. Together we have delivered some great outcomes.

An efficient audit – we delivered the accounts audit over 2 months before the deadline and in line with the timescale we agreed with you. Our audit team are knowledgeable and experienced in your financial accounts and systems. Our relationship with your team provides you with a financial statements audit that continues to finish ahead of schedule, releasing your finance team for other important work.

Improved processes – during the year we reviewed your IT controls and proposed recommendations for improvement that, if implemented, may facilitate a more efficient audit approach in the future.

Through the Value for Money conclusion we provided you with assurance on your operational effectiveness of your financial planning, Orbis partnership and addressing the issues raised by the Ofsted inspection of children's services.

Ad-hoc advice – we have provided support to the Council in advising on certain areas as required, such as accounting for the Better Care Fund, revising your approach to the Minimum Revenue Provision and your proposed approach to utilising capital receipts more flexibly in 2016/17.

Sharing our insight – we provided regular updates to the Audit and Governance Committee covering best practice. Areas we covered included our reports on Innovation in public financial management, Knowing the Ropes – Audit Committee; Making devolution work and Reforging local government.

Supporting development – we met with the Audit Committee Vice-Chair to discuss the key elements of Audit Committee effectiveness and highlighted areas that may wish to be considered for improvement.

We will also continue to work with you and support you over the next financial year. We recognise the strategic importance the Council attaches to its trading companies and will continue to support in this area in the future by:

- Continuing to liaise closely with Surrey Choices senior management, supporting them to deliver the company's Strategic Action Plan
- Reflecting the strength of partnership arrangements between the Council and its companies as part of our Value for Money conclusion work
- Continuing to communicate promptly to the Council our findings from our work with the companies

Working with the Council (continued)

Working with you in 2016/17 Highways Network Asset

The Code of Practice on Local Authority Accounting (the Code) requires authorities to account for Highways Network Asset (HNA) at depreciated replacement cost (DRC) from 1 April 2016. The Code sets out the key principles but also requires compliance with the requirements of the recently published Code of Practice on the Highways Network Asset (the HNA Code), which defines the assets or components that will comprise the HNA. This includes roads, footways, structures such as bridges, street lighting, street furniture and associated land. These assets should always have been recognised within Infrastructure Assets.

The Code includes transitional arrangements for the change in asset classification and the basis of measurement from depreciated historic cost (DHC) to DRC under which these assets will be separated from other infrastructure assets, which will continue to be measured at DHC.

This is expected to have a significant impact on the Council's 2016/17 accounts, both in values and levels of disclosure, and may require considerable work to establish the opening inventory and condition of the HNA as at 1 April 2016.

Under the current basis of accounting values will only have been recorded against individual assets or components acquired after the inception of capital accounting for infrastructure assets by local authorities. Authorities may therefore have to develop new accounting records to support the change in classification and valuation of the HNA.

The nature of these changes means that Finance officers will need to work closely with colleagues in the highways department and potentially also to engage other specialists to support this work.

Some of the calculations are likely to be complex and will involve the use of external models, a combination of national and locally generated rates and a number of significant estimates and assumptions.

We have been working with the Council on the accounting, financial reporting and audit assurance implications arising from these changes. We have issued two Client Briefings which we have shared with the finance team. We will issue further briefings during the coming year to update the Council on key developments and emerging issues.

This significant accounting development is likely to be a significant risk for our 2016/17 audit, so we have already had some preliminary discussions with the Council to assess the progress it is making in this respect. Our discussions with Council Officers to date has highlighted the following:

- The Council has had an implementation plan in place since 2014 and is well-advanced in preparing the required disclosures in its 2016/17 financial statements
- Work is on-going to finalise completion of inventory and accounting records, and in particular to ensure the required assurance is gained over the completeness of records held
- We have agreed with the Council's finance and highways teams that we will undertake early work in this area in October 2016, with the Council being a model case for our planned audit approach across our portfolio of local authority clients

We will continue to liaise closely with the senior finance team during 2016/17 on this important accounting development, with timely feedback on any emerging issues.

The audit risks associated with this new development and the work we plan to carry out to address them will be reflected in our 2016/17 audit plan.

Appendix A: Reports issued and fees

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

Fees

	Proposed fee £	Final fee £
Council audit	142,098	142,098
S. E. Business Services Limited*	15,000	15,000
Surrey Choices Limited*	18,000	18,000
Halsey Garton Property Limited*	9,000	9,000
Total audit fees (excluding VAT)	184,098	184,098

Fees for other services

Service	Fees £
Audit related services:	
Certification of Teachers' Pensions return (2015/16)**	4,000
Non-audit services:	
None	Nil

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The proposed fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA).

* Work still in progress – completion due in September 2016.

** To be completed in Autumn 2016.

Reports issued

Report	Date issued
Audit Plan	February 2016
Audit Findings Report	July 2016
Annual Audit Letter	September 2016



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