

# The Annual Audit Letter for Surrey County Council

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Year ended 31 March 2017

September 2017  
Page 27

**Ciaran T McLaughlin**

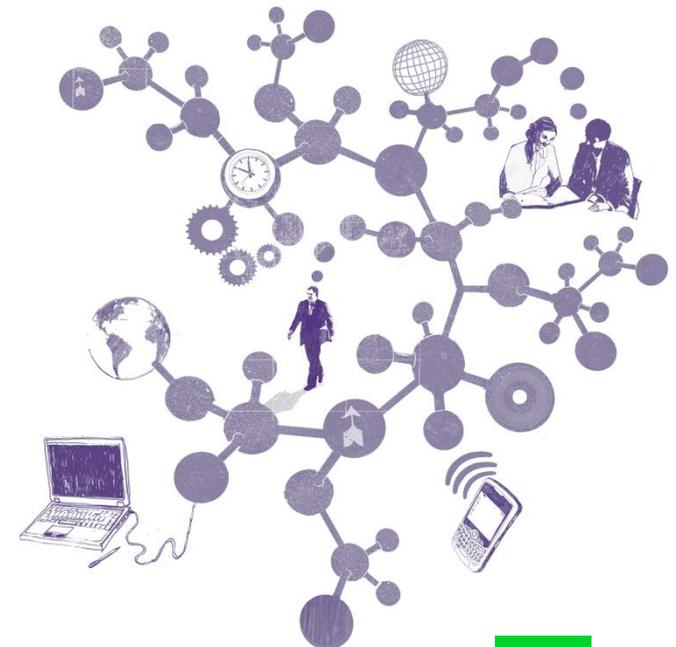
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# Contents

<b>Section</b>	<b>Page</b>
1. Executive summary	3
2. Audit of the accounts	5
3. Value for Money conclusion	12

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# Executive summary

## Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work we have carried out at Surrey County Council (“the Council”) for the year ended 31 March 2017.

This Letter provides a commentary on the results of our work to the Council and its external stakeholders, and highlights issues 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 & Governance Committee (as those charged with governance) in our Audit Findings Report on 27 July 2017.

## 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
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion).

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 7 August 2017.

### 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 2017 except for the requirement for continued improvements to children's services. We therefore qualified our value for money conclusion in our audit opinion on 7 August 2017.

### Use of additional powers and duties

We are required under the Act to give electors the opportunity to raise questions about the Council's accounts and we consider and decide upon objections received in relation to the accounts.

We received one formal objection to the accounts during the official accounts inspection period, which was reviewed and responded to accordingly.

### Whole of government accounts

We plan to complete work on the Council's consolidation return in line with the guidance issued by the NAO. We will complete this work by 29 September 2017.

### Certificate

We are currently unable to formally certify that we have completed the audit of the accounts of the Council as we have not yet completed the work required under the Code on the Council's Whole of Government Accounts or given an audit opinion on the pension fund annual report.

### Certification of grants

We also carry out work to certify the Council's Teacher's Pension return. Our work on this claim will be finalised by the 30 November 2017 deadline. We will report the results of this work to the Audit & Governance Committee in our Annual Certification Letter.

### Working with the Council/Authority

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 2017**

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# Audit of the accounts

## Our audit approach

### Materiality

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

We determined materiality to be £26.8 million for our audit of the Council's accounts, which is 1.5% of the Council's gross revenue expenditure. We used this benchmark as in our view, users of the Council's accounts are most interested in how you have spent the income you have raised from taxation and grants during the year.

We set a lower threshold of £1.3 million, above which we reported errors to the Audit & Governance Committee in our Audit Findings Report.

### Pension Fund –

For the audit of the Surrey Pension Fund accounts, we determined materiality to be £38.6 million, which is 1% of the Fund's net assets. 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 threshold of £2 million above which we reported errors to the Audit & Governance Committee.

### The scope of our audit

Our audit involves obtaining enough evidence about the amounts and disclosures in the financial statements to give reasonable assurance 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 the Director of Finance & Officer 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 included in the Statement of Accounts on which we gave 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 – Surrey County 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	Findings and conclusions
<p><b>Management over-ride of controls</b> ISA (UK&amp;I) 240 requires us to presume that the risk of management over-ride of controls is present in all entities.</p>	<ul style="list-style-type: none"> <li>We reviewed your entity controls</li> <li>We reviewed your journal entry process</li> <li>We used risk based analysis to test a selection of journals posted in the year back to supporting documentation</li> <li>We reviewed management's accounting estimates, judgements and decisions made by management</li> <li>We reviewed any transactions we deemed to be unusual and significant to the users' understanding of the financial statements.</li> </ul>	<p>Our audit work did not identify any material issues in respect of the risk identified.</p>
<p><b>The revenue cycle includes fraudulent transactions</b> Under ISA (UK&amp;I) 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.</p>	<p>Having considered the risk factors set out in ISA240 and the nature of the revenue streams at Surrey County Council, we determined that the risk of fraud arising from revenue recognition could be rebutted, because:</p> <ul style="list-style-type: none"> <li>there is little incentive to manipulate revenue recognition;</li> <li>opportunities to manipulate revenue recognition are very limited; and</li> <li>the culture and ethical frameworks of local authorities, including Surrey County Council, mean that all forms of fraud are seen as unacceptable.</li> </ul> <p>Therefore we did not consider this to be a significant risk for Surrey County Council.</p>	<p>Our audit work did not identify any material issues in respect of the rebutted fraudulent revenue recognition risk.</p> <p>Through our work we identified one issue whereby the Council had not accounted for the deferred capital receipt element in respect of an asset disposed of in the year. Thereby, understating Short term debtors and deferred capital receipts reserve as well as understating the gain on disposal of non-current assets. This misstatement was not due to fraud.</p> <p>Our audit work has not identified any further material issues in respect of revenue recognition.</p>

# Audit of the accounts (continued) – Surrey County 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	Findings and conclusions
<p><b>The expenditure cycle includes fraudulent transactions</b></p> <p>Practice Note 10 requires us to consider the risk of material misstatement due to fraudulent financial reporting that may arise from manipulation of expenditure recognition, especially where the body is required to meet targets. Although we did not report on our assessment to you as part of our planning we have included it here in the interests of completeness and transparency.</p>	<p>Having considered the risk factors and the nature of the expenditure at Surrey County Council, we determined that the risk of fraud arising from the expenditure transactions could be rebutted, because:</p> <ul style="list-style-type: none"> <li>• incentive and opportunities to manipulate expenditure are very limited.</li> <li>• the culture and ethical frameworks of local authorities, including Surrey County Council, mean that all forms of fraud are seen as unacceptable.</li> <li>• we are already reviewing unusual significant transactions, accounting estimates and journal entries in addressing the risk of management override of control above.</li> </ul>	<p>Our audit work did not identify any material issues in respect of the risk identified.</p>
<p><b>Valuation of property plant and equipment</b></p> <p>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 the current value. This represents a significant estimate by management in the financial statements.</p>	<ul style="list-style-type: none"> <li>• Reviewed management's processes and assumptions for the calculation of the estimate.</li> <li>• Reviewed the competence, expertise and objectivity of any management experts used.</li> <li>• Reviewed the instructions issued to valuation experts and the scope of their work</li> <li>• Held discussions with the Council's valuer about the basis on which the valuation was carried out, challenging the key assumptions.</li> <li>• Reviewed and challenged the information used by the valuer to ensure it was robust and consistent with our understanding.</li> <li>• Tested revaluations made during the year to ensure they were input correctly into the Council's asset register</li> <li>• Evaluated the assumptions made by management for those assets not revalued during the year to assess how management satisfied themselves that these were not materially different to current value.</li> </ul>	<p>Our audit work did not identify any material issues in respect of the risk identified.</p>

# Audit of the accounts (continued) – Surrey County 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	Findings and conclusions
<p><b>Valuation of pension fund net liability</b></p> <p>The Council's pension fund net liability, as reflected in its balance sheet, represents a significant estimate in the financial statements.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> <li>Identified the controls put in place by management to ensure that the pension fund net liability was not materially misstated and assessed whether those controls were implemented as expected and whether they were sufficient to mitigate the risk of material misstatement.</li> <li>Reviewed the competence, expertise and objectivity of the actuary who carried out the Council's pension fund valuation.</li> <li>Gained an understanding of the basis on which the IAS 19 valuation was carried out, undertaking procedures to confirm the reasonableness of the actuarial assumptions made.</li> <li>Reviewed the consistency of the pension fund net liability disclosures in notes to the financial statements with the actuarial report from the Council's actuary.</li> </ul>	<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	Findings and conclusions
<p><b>The revenue cycle includes fraudulent transactions</b></p> <p>Under ISA (UK&amp;I) 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.</p> <p>This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.</p>	<p>Having considered the risk factors set out in ISA240 and the nature of the revenue streams at Surrey Pension Fund, we determined that the risk of fraud arising from revenue recognition could be rebutted, because:</p> <ul style="list-style-type: none"> <li>• there is little incentive to manipulate revenue recognition;</li> <li>• opportunities to manipulate revenue recognition are very limited; and</li> <li>• the culture and ethical frameworks of local authorities, including Surrey County Council, mean that all forms of fraud are seen as unacceptable.</li> </ul> <p>Therefore we did not consider this to be a significant risk for Surrey Pension Fund.</p>	<p>Our audit work did not identify any material issues in respect of the risk identified.</p>
<p><b>The expenditure cycle includes fraudulent transactions</b></p> <p>Practice Note 10 requires us to consider the risk of material misstatement due to fraudulent financial reporting that may arise from manipulation of expenditure recognition, especially where the body is required to meet targets. Although we did not report on our assessment to you as part of our planning we have included it here in the interests of completeness and transparency.</p>	<p>Having considered the risk factors and the nature of the expenditure at Surrey Pension Fund, we determined that the risk of fraud arising from the expenditure transactions could be rebutted, because:</p> <ul style="list-style-type: none"> <li>• incentive and opportunities to manipulate expenditure are very limited.</li> <li>• the culture and ethical frameworks of local authorities, including Surrey County Council, mean that all forms of fraud are seen as unacceptable.</li> <li>• we are already reviewing unusual significant transactions, accounting estimates and journal entries in addressing the risk of management override of control above.</li> </ul>	<p>Our audit work did not identify any material issues in respect of the risk identified.</p>

Page 35

# Audit of the accounts (continued) – 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	Findings and conclusions
<p><b>Level 3 investments – Valuation is incorrect</b></p> <p>Under ISA (UK&amp;I) 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>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> <li>• Updated our understanding of your process for valuing Level 3 investments through discussions with relevant personnel</li> <li>• For a sample of private equity investments we tested valuations by obtaining and reviewing the audited accounts at latest date for individual investments and agreeing these to the fund manager reports at that date. We reconciled these values to the values as at year end 31 March 2017 with reference to known movements in the intervening period.</li> <li>• Reviewed the nature and basis of estimated values and considered what assurance management had over the year end valuations provided for these type of investments.</li> </ul>	<p>Our audit work did not identify any material issues in respect of the risk identified.</p>

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# Audit of the accounts

## Audit opinion

We gave an unqualified opinion on the Council's accounts and on the Pension Fund on 7 August 2017, in advance of the 30 September 2017 national deadline.

The Council made the accounts available for audit in line with the agreed timetable, and provided a good set of supporting working papers. The finance team responded promptly and efficiently to our queries during the audit.

## Issues arising from the audit of the accounts

We reported the key issues from our audit of the accounts of the Council to the Council's Audit & Governance Committee on 27 July 2017.

In addition to the key audit risks reported above, we identified the following recommendations during our audit that we have asked the Council's management to address for the next financial year:

- Ensure processes are in place to capture all schools which have converted to academies during the year and moved off Balance Sheet, onto the Fixed Asset Register.
- Ensure processes and the communication channels between different Council departments are aligned such that any contractual information that may affect revenue recognition are known to all relevant parties.

## Pension fund accounts

We also reported the key issues from our audit of accounts of the Pension Fund hosted by the Council to the Council's Audit & Governance Committee on 27 July 2017.

## Annual Governance Statement and Narrative Report

We are 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 consistent with the supporting evidence provided by the Council and with our knowledge of the Council.

## Whole of Government Accounts (WGA)

We plan to carry out work on the Council's consolidation schedule in line with instructions provided by the NAO by 29 September 2017.

# 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 2016 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

In June 2015, a report on the inspection of services for children in need of help and protection, looked after children and care leavers, concluded that, overall, children's services in Surrey County Council were judged to be inadequate. You have been responsive to the issues identified by the inspection and undertaken a series of actions, as part of a three year strategy, to improve children's services. However recent Ofsted letters highlight areas where improvement is still required.

Based on our review, with the exception of the matter set out above in relation to arrangements for management of children's services, we are satisfied that in all significant respects you have put in place proper arrangements to secure economy, efficiency and effectiveness in your use of resources for the year ended 31 March 2017.

# Value for Money

**Table 2: Value for money risks**

Risk identified	Work carried out	Findings and conclusions
<p><b>Financial Health</b> The Council had historically managed its finances well and had consistently achieved savings targets. It was on course to achieve a balanced budget for 2016/17. However, following the most recent settlement, the scale of efficiencies and savings required was sizeable and the Council had decided to hold a referendum in May 2017 where it would ask electors to agree a proposed increase of 15% in the level of Council Tax. There was a risk that if the Council did not receive the mandate which it had asked for from tax payers, it would need to draw back significantly on its proposed spending programme.</p> <p>However, it should be noted that a decision was made by the Council not to go ahead with the planned referendum.</p>	<ul style="list-style-type: none"> <li>reviewed the Council's progress in updating its medium term financial strategy and the reports to Members</li> <li>reviewed the outturn position for 2016/17 and the budget plans for 2017/18 and 2018/19</li> <li>met with key officers to discuss key strategic challenges and the Council's proposed response.</li> </ul>	<p>You have a history of good financial management and delivered a surplus out turn for 2016/17, enabling you to increase reserve levels. You face a significant challenge to balance the budget going forward, with a savings target of £104m in 2017/18. The gap between income and expenditure over the next few years is being driven by escalating social care costs and a continued reduction in central government grant income. You have costed plans in place to reduce the gap by making efficiencies to services, reducing selected non-statutory services and using your reserves. You are pursuing innovative schemes and working with other councils to save money. You are also looking at methods of income generation via investment in property. Even with all these schemes in place, early budget monitoring indicates potential for an overspend (approx. 2% of expenditure) in 2017/18. You recognise the need for management action to ensure the Council spends within its available resources. You are aware of the financial environment and have robust arrangements in place to monitor budgets against actuals, identify areas of focus and take action. Even with your strong track record of making efficiency savings the scale of the task going forward will require a strategic approach.</p> <p><b>On that basis we concluded that the risk was sufficiently mitigated and the Council has adequate arrangements</b></p>
<p><b>Ofsted inspection of children's services</b> 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 and 2015/16. Until such time as Ofsted confirmed adequate arrangements are in place this remains a significant risk.</p>	<ul style="list-style-type: none"> <li>reviewed update reports from Ofsted and the Department for Education as they become available and took these into account in forming our conclusion.</li> </ul>	<p>We reviewed the Ofsted letters dated 10 February 2017 and 13 June 2017.</p> <p>It is clear from these letters that you have made good progress against your improvement plan since the Ofsted inspection in June 2015 and should be commended for the outcome of this work. However Ofsted point out some areas where more work is required to improve the service, some areas where good practice has been inconsistent and some areas where improvement has been too slow.</p> <p><b>Whilst recognising the progress you have made in response to the Ofsted report, your work in these areas is on-going and, accordingly, we propose to qualify our value for money conclusion in this respect.</b></p>

# 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 £	Actual fees £
Statutory audit of the Council	142,098	142,098
Statutory audit of Pension Fund	27,105	27,105
Audit of South East Business Services Ltd	12,000	TBC
Audit of Surrey Choices Ltd	17,000	TBC
Audit of Halsey Garton Property Ltd	12,500	TBC
<b>Total fees (excluding VAT)</b>	<b>210,703</b>	<b>TBC</b>

Page 40

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

## Reports issued

Report	Date issued
Audit Plan	March 2017
Audit Findings Report	July 2017
Annual Audit Letter	September 2017

## Fees for other services

Service	Fees £
<b>Audit related services:</b>	
• Certification of Teachers' Pension return for Surrey County Council (2016-17)	4,000
• Certification of Teachers' Pension return for Surrey Choices Ltd (2016-17)	3,500
Non-audit services	Nil
None	

## Other services

- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The table above summarises all other services which were identified.
- We have considered whether other services might be perceived as a threat to our independence as the Council's auditor and have ensured that appropriate safeguards are put in place, as reported in our Audit Findings Report.
- There were no non-audit services provided to the Council by Grant Thornton in 2016-17.

# Reports issued and fees continued

We have considered whether other services might be perceived as a threat to our independence as the Council's auditor and have ensured that appropriate safeguards have been applied to mitigate these risks.

	Service provided to	Fees	Threat identified	Safeguards
Page 41	<b>Audit related services</b>			
	Certification of Teachers' Pension return for Surrey County Council (2016-17)	4,000	<ul style="list-style-type: none"> <li>Self- Interest</li> </ul>	<p>This is a recurring fee and therefore a self-interest threat exists. However, the level of this recurring fee taken on its own is not considered to be a significant threat to independence as the fee for this work in comparison to the total fee for the audit (£142,098k) for the Council and in particular to Grant Thornton UK LLP overall turnover. Furthermore, the work relates to audit related services for which there is a fixed fee and no contingent element to the fee. These factors are deemed to adequately mitigate the perceived self-interest threat to an acceptable level.</p> <p>As Marcus Ward's wife works as a teacher in Surrey he will not be part of the team who carries out the audit work or quality review.</p>
	Certification of Teachers' Pension return for Surrey Choices Ltd (2016-17)	3,500	<ul style="list-style-type: none"> <li>Self-Interest</li> </ul>	<p>This is a recurring fee and therefore a self-interest threat exists. However, the level of this recurring fee taken on its own is not considered to be a significant threat to independence as the fee for this work in comparison to the total fee for the audit for the parent authority and in particular to Grant Thornton UK LLP overall turnover. Furthermore, the work relates to audit related services for which there is a fixed fee and no contingent element to the fee. These factors are deemed to adequately mitigate the perceived self-interest threat to an acceptable level.</p>
	<b>Non-audit services</b>	None	Nil	N/a
	<b>TOTAL</b>	£7,500		



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