

# Annual Audit Letter

*Year ending 31 March 2018*

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**Surrey County Council including Surrey Pension Fund**

August 2018

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# Executive Summary

## Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Surrey County Council (the Council) and its subsidiaries (the group) for the year ended 31 March 2018.

This Letter is intended to provide a commentary on the results of our work to the group and 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 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 26 July 2018.

## Respective 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 and group'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 and group's financial statements, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

## Our work

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<b>Materiality</b>	We determined materiality for the audit of the group's financial statements to be £30.3m, which is 2% of the group's gross revenue expenditure. We determined materiality for the audit of the pension fund accounts administered by the Council to be £38.7m, which is 1% of the pension fund's net assets.
<b>Financial Statements opinion</b>	We gave an unqualified opinion on the group's financial statements on 31 July 2018. We gave an unqualified opinion on the pension fund accounts on 31 July 2018.
<b>Whole of Government Accounts (WGA)</b>	We completed work on the Council's consolidation return following guidance issued by the NAO.
<b>Use of statutory powers</b>	We did not identify any matters which required us to exercise our additional statutory powers.
<b>Value for Money arrangements</b>	We have completed our work in respect of Children's Services but have not been able to complete our work in respect of the Council's Financial Health at present. See page 10 for more detail.
<b>Certificate</b>	We are unable to certify that we have completed the audit of the accounts of Surrey County Council until: <ul style="list-style-type: none"><li>• we have issued our report on the consistency of the pension fund financial statements when the Council has prepared the Pension Fund Annual Report</li><li>• we have completed our work under Section 20(1)(c) of the Local Audit and Accountability Act 2014 to be satisfied that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources</li></ul>

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council, subsidiary and Pension Fund staff.

# Audit of the Accounts

## Our audit approach

### Materiality

In our audit of the group's financial statements, 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 the audit of the group and Council's accounts to be £30.3m, which is 1.5% of the group's gross revenue expenditure. We used this benchmark as, in our view, users of the group and Council's financial statements are most interested in where the group and Council has spent its revenue in the year.

We set a lower threshold of £1.5m, above which we reported errors to the Audit & Governance Committee in our Audit Findings Report.

### Pension Fund Materiality

For the audit of Surrey Pension Fund accounts, we determined materiality to be £38.7 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 £1.9m above which we reported errors to the Audit & Governance Committee.

### The scope of our audit

Our audit involves obtaining sufficient 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 accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the 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 remainder of the Statement of Accounts, the narrative report and the annual governance statement to check they are consistent with our understanding of the group and with the financial statements included in the Statement of Accounts on which we gave our opinion.

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

Our audit approach is based on a thorough understanding of the group'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

## Significant Audit Risks

These are the significant 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 override of controls</b></p> <p>Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.</p> <p>We identified management override of controls as a risk requiring special audit consideration.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> <li>gained an understanding of the accounting estimates, judgements applied and decisions made by management and considered their reasonableness</li> <li>obtained a full listing of journal entries and identified and tested journal entries for appropriateness in accordance with the assessed level of risk associated with each journal</li> <li>evaluated the rationale for any changes in accounting policies or significant unusual transactions.</li> </ul>	<p>Our audit work did not identify any issues in respect of management override of controls.</p>
<p><b>Valuation of property, plant and equipment</b></p> <p>The Council revalues its land and buildings on an rolling basis to ensure that carrying value is not materially different from fair value. This represents a significant estimate by management in the financial statements.</p> <p>We identified the valuation of land and buildings revaluations and impairments as a risk requiring special audit consideration.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> <li>reviewed management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work</li> <li>considered the competence, expertise and objectivity of any management experts used</li> <li>discussed the basis on which the valuation is carried out with the valuer and challenged the key assumptions</li> <li>reviewed and challenged the information used by the valuer to ensure it is robust and consistent with our understanding.</li> <li>tested revaluations made during the year to ensure they are input correctly into the Council's asset register</li> <li>evaluated the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value</li> </ul>	<p>Our audit work did not identify any issues in respect of the valuation of property, plant and equipment.</p>

# Audit of the Accounts - continued

## Significant Audit Risks

These are the significant 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 the pension fund net liability</b> The Council's pension fund asset and liability as reflected in its balance sheet represent a significant estimate in the financial statements.</p> <p>We identified the valuation of the pension fund net liability as a risk requiring special audit consideration.</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 liability is not materially misstated. We also assessed whether these controls were implemented as expected and whether they are sufficient to mitigate the risk of material misstatement</li> <li>evaluated the competence, expertise and objectivity of the actuary who carried out your pension fund valuation. We gained an understanding of the basis on which the valuation is carried out</li> <li>undertook procedures to confirm the reasonableness of the actuarial assumptions made.</li> <li>checked the consistency of the pension fund asset and liability disclosures in notes to the financial statements with the actuarial report from your actuary</li> </ul>	<p>Our audit work did not identify any issues in respect of the valuation of the pension fund net liability.</p>

# Audit of the Accounts - Pension Fund

## Pension Fund Significant Audit Risks

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>Management override of controls</b></p> <p>Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.</p> <p>We identified management override of controls as a risk requiring special audit consideration.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> <li>gained an understanding of the accounting estimates, judgements applied and decisions made by management and considered their reasonableness</li> <li>obtained a full listing of journal entries, identified and tested unusual journal entries for appropriateness</li> <li>evaluated the rationale for any changes in accounting policies or significant unusual transactions</li> </ul>	<p>Our audit work did not identify any issues in respect of management override of controls.</p>
<p><b>The valuation of Level 3 investments is incorrect</b></p> <p>Under ISA 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> <p>We identified the valuation of level 3 investments as a risk requiring special audit consideration.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> <li>gained an understanding of the Fund's process for valuing level 3 investments and evaluated the design of the associated controls</li> <li>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</li> <li>tested the valuation for a sample of investments by obtaining and reviewing the audited accounts, (where available) at the latest date for individual investments and agreeing these to the fund manager reports at that date. Reconciled those values to the values at 31 March 2017 with reference to known movements in the intervening period.</li> </ul>	<p>Our audit work did not identify any issues in respect of the valuation of Level 3 investments.</p>

# Audit of the Accounts

## Audit opinion

We gave an unqualified opinion on the group's financial statements on 31 July 2018.

## Preparation of the accounts

The group presented us with draft accounts in accordance with the national deadline, 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.

## Reporting

We reported the audit findings from our audit to the Council's Audit & Governance Committee on 26 July 2018.

## 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 alongside the Statement of Accounts in line with the national deadlines.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Council and with our knowledge of the Council.

## Whole of Government Accounts (WGA)

We carried out work on the Council's Data Collection Tool in line with instructions provided by the NAO. We issued an assurance statement which did not identify any issues for the group auditor to consider on 30 August 2018.

**Pension fund accounts** We gave an unqualified opinion on the pension fund accounts on 31 July 2018.

We also reported the key issues from our audit of the pension fund accounts to the Council's Audit & Governance Committee on 26 July 2018.

The Pension Fund draft accounts provided for audit were not of sufficient quality, a significant number of figures were rolled forward from the prior year and had not been updated for 2017/18. The original working papers provided to the audit team did not agree to the financial statements and key working papers were missing from the requested list. There were a number of delays in receiving information.

## Certificate of closure of the audit

We are unable to certify that we have completed the audit of the accounts of Surrey County Council until:

- we have issued our report on the consistency of the pension fund financial statements when the Council has prepared the Pension Fund Annual Report
- we have completed the work necessary to issue our Whole of Government Accounts assurance statement
- we have completed our work under Section 20(1)(c) of the Local Audit and Accountability Act 2014 to be satisfied that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources

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# Value for Money conclusion

## Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 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

We have completed our work in respect of Children's Services but have not been able to complete our work in respect of the Council's Financial Health at present. The Council has asked the Chartered Institute of Public Finance and Accountancy (CIPFA) to undertake a review of its financial resilience. We are yet to receive a copy of the Terms of Reference for the CIPFA review or a copy of the resulting report. Our work has been delayed (see Financial health paragraph opposite for detail). We will issue a supplementary report to you at a later date when we have completed our value for money work.

## Financial Health

We had identified the Council's medium term financial health as a significant risk during our planning work earlier this year. We met with the Director of Finance as part of our planning process and agreed that we would review the 2018/19 budget position and savings plans and proposals. In May 2018 we provided the Council with a draft terms of reference for an in-depth review of the financial position. The Council had separately asked CIPFA to carry out a review of its financial resilience among other things. We were told the CIPFA review would have considerable overlap with the work that we had proposed so we agreed to delay any detailed work until we had seen the terms of reference and findings from the CIPFA review. At the time of writing we have not received CIPFA's Terms of Reference or their interim report, however we now understand that it is unlikely that CIPFA's work will overlap with our proposed value for money work. We will therefore need to carry out our work as previously planned.

We are therefore not in a position to issue our VFM conclusion at this time. Once we have been able to carry out and conclude our work we report our findings to you as soon as possible via a supplementary report.

# Value for Money conclusion

## Key Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>Financial health</b>  <b>You have a strong track record of delivering a budget underspend at year-end, despite reduced funding from central government. Forecast revenue budget outturn for 2017/18 is a £6m overspend.</b></p>	<p>As part of our work we will:</p> <ul style="list-style-type: none"> <li>• Consider the MTFP and the key assumptions and savings plans for 2018/19</li> <li>• Consider the transformation plan including the transformation projects</li> <li>• Consider the CIPFA report including any further work that they are planning to do</li> <li>• Interview various stakeholders</li> <li>• Review budget outturn reports for 2018/19 to date</li> </ul>	<p>We are unable to conclude on this risk at the current time for the reasons set out on the previous page.</p>
<p><b>Children's services</b>  <b>Ofsted issued a critical report on children's services in 2014/15 and you are currently subject to follow up review. We issued a qualified except for conclusion in 2014/15, 2015/16, and 2016/17 due to Department for Education interventions.</b></p>	<p>We have reviewed the re-inspection of services for children in need of help and protection, children looked after and care leavers Ofsted report published in May 2018. The report rated children's services across the County as inadequate. This was a follow up report to the June 2015 report when children's services were also rated as inadequate.</p>	<p>Our review of the most recent Ofsted report has led us to conclude that the processes and procedures the Council has in place in relation to children's services are not conducive to providing value for money for residents.</p>

# A. Reports issued and fees

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

## Reports issued

Report	Issued
Audit Plan	March 2018
Audit Findings Report	July 2018
Annual Audit Letter	August 2018

## Fees for non-audit services

Service	Fees £
<b>Audit related services</b>	
- Certification of Teachers' Pensions return for Surrey County Council	4,000
- Certification of Teachers' Pensions return for Surrey Choices Ltd	3,500
<b>Non-Audit related services</b>	
- CFO Insights annual subscription	12,500

## Fees

	Planned £	Actual fees £
Surrey County Council	142,098	142,098
Surrey Choices Ltd	17,000	17,000
Halsey Garton property Ltd	12,500	12,500
South East Business Services Ltd	12,000	12,000
Pension Fund	27,105	TBC
<b>Total fees</b>	<b>210,703</b>	<b>TBC</b>

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

NB The audits of the subsidiary companies and the grant certification work fall outside the remit of Public Sector Audit Appointments Limited, therefore no scale fee is produced. Fee variations are subject to approval by Public Sector Audit Appointments Ltd. The final fee for the Pension Fund audit is pending agreement of a fee variation by PSAA for additional work completed in relation to delays and multiple versions of the accounts.

## Non-audit services

- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the group. The table above summarises all non-audit services which were identified.
- We have considered whether non-audit services might be perceived as a threat to our independence as the group's auditor and have ensured that appropriate safeguards are put in place.

The above non-audit services are consistent with the group's policy on the allotment of non-audit work to your auditor.



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