



The Annual Audit Letter for Surrey County Council

Year ended 31 March 2019

30 August 2019



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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), and the Surrey Pension Fund for the year ended 31 March 2019.

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 29 July 2019.

Our work

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.

Materiality	We determined materiality for the audit of the Council's financial statements to be £30 million (£30.1 million Group), which is 1.5% of the Council's gross revenue expenditure. We determined materiality for the Pension Fund audit to be £40 million based on 1% of net assets in the fund.
Financial Statements opinion	We gave an unqualified opinion on the group's financial statements on 31 July 2019. We gave an unqualified opinion on the pension fund financial statements on 31 July 2019.
Whole of Government Accounts (WGA)	We completed work on the Council's consolidation return following guidance issued by the NAO.
Use of statutory powers	We did not identify any matters which required us to exercise our additional statutory powers.

Executive Summary

Value for Money arrangements We were not satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources because of weaknesses in resilience of council finances and results of Ofsted reports into children's services provided by Surrey County Council.

We therefore issued an adverse value for money conclusion in our audit report to the Council 31 July 2019.

Certification of Grants We also carry out work to certify the Council's annual 'EOYC' Teacher's Pensions claim. Our work on this claim is not yet complete and is anticipated to be completed in Autumn 2019. We will report the results of this work to the Audit & Governance Committee separately as necessary.

Certificate We are required to give an opinion on the consistency of the pension fund financial statements of the Authority included in the Pension Fund Annual Report with the pension fund financial statements included in the Statement of Accounts. The Local Government Pension Scheme Regulations 2013 require authorities to publish the Pension Fund Annual Report by 1 December 2019. As the Authority has not prepared the Pension Fund Annual Report at the time of this report we have yet to issue our report on the consistency of the pension fund financial statements. Until we have done so, we are unable to certify that we have completed the audit of the financial statements in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice.

We cannot formally conclude the audit and issue an audit certificate in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice until we have completed the work necessary to issue our Whole of Government Accounts (WGA) Component Assurance statement for the Authority for the year ended 31 March 2019. We are satisfied that this work does not have a material effect on the financial statements or on our conclusion on the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.

Working with the Council

During the year we have delivered a number of successful outcomes with you:

- An efficient audit – we delivered an efficient audit with you in July, delivering the financial statements by the statutory deadline of 31 July
- Understanding your operational health – through our value for money work we have provided you with assurance on your operational effectiveness

- Sharing our insight – we provided regular audit committee updates covering best practice. We also shared our thought leadership reports
- Providing training – we provided your teams with training on financial statements and annual reporting via our annual local government accounts workshop

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
August 2019

Audit of the Financial Statements

Our audit approach

Materiality

In our audit of the Council and group 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 financial statements to be £30 million, which is 1.5% of the group's gross revenue expenditure. We determined materiality for the audit of the Council's financial statements to be £30.1 million, which is 1.5% of the Council'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 £1.5 million, above which we reported errors to the Audit & Governance Committee in our Audit Findings Report.

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 financial statements and the narrative report and annual governance statement published alongside the financial statements to check it is consistent with our understanding of the Council and with the financial statements included in the Annual Report 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 was based on a thorough understanding of the Council and 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 Financial Statements

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>Valuation of land and buildings</p> <p>The Council revalues its land and buildings on a rolling basis to ensure that carrying value of assets is not materially different from current value. This represents a significant estimate by management in the financial statements due to the size of the numbers involved (£1.09 billion in the prior year) and the sensitivity of the estimate to changes in key assumptions.</p> <p>Additionally, management are required to address the risk that the carrying value of assets not revalued as at 31 March 2019 in the Council financial statements may be materially different from the current value at the financial statements date, where a rolling programme is used.</p> <p>We identified the valuation of land and buildings revaluations and impairments as a significant risk, which was one of the most significant assessed risks of material misstatement.</p>	<p>We have:</p> <ul style="list-style-type: none"> • reviewed management’s processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work; • considered the competence, expertise and objectivity of any management experts used; • discussed with the valuer the basis on which the valuation is carried out and challenge of the key assumptions; • reviewed and challenged the information used by the valuer to ensure it is robust and consistent with our understanding; • tested revaluations made during the year to ensure they are input correctly into the Council’s asset register, • reviewed significant asset valuation movements against movements in indices relating to land and building values since the most recent previous valuation for reasonableness, and challenged these when necessary; • 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, including evaluation of management’s paper on assets not revalued against the requirements of the CIPFA code; • engaged our own external auditor’s expert to support our assessment of the valuer’s work in preparation of valuation figures for the purposes of the financial statements as at 31 March 2019; and • challenged management to support the valuation of the Eco Park PFI development in assets under construction. <p>As identified above, it was determined through analysis of the significant movements in valuation of land and buildings this year that it was necessary for the audit team to engage their own external valuer to assist in reviewing the valuation methodology and assumptions employed by the Council’s external valuer.</p>	<p>Our work identified material corrections to be made to the financial statements in respect of historical valuations of land & buildings. This matter was reported in our ISA 260 audit report.</p> <p>Aside from the above adjusted misstatement our audit has not identified any issues in respect of valuation of land & buildings.</p>

Audit of the Financial Statements

Significant Audit Risks - continued

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>Valuation of net pension liability</p> <p>The Authority's pension fund net liability, as reflected in its balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements.</p> <p>The pension fund net liability is considered a significant estimate due to the size of the numbers involved and the sensitivity of the estimate to changes in key assumptions.</p> <p>We therefore have identified valuation of the Authority's pension fund net liability as a significant risk, which was one of the most significant assessed risks of material misstatement.</p>	<p>We have:</p> <ul style="list-style-type: none"> • updated our understanding of the processes and controls put in place by management to ensure that the Council's pension fund net liability is not materially misstated and evaluated the design of the associated controls; • evaluated the instructions issued by managements to their management expert for this estimate and the scope of the actuary's work; • assessed the competence, capabilities and objectivity of the actuary who carried out the Council's pension fund liability; • tested the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary; and • undertaken procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report. <p>The Court of Appeal ruled in December 2018 that there was age discrimination in the judges and firefighters pension schemes where there were transitional protections given to scheme members. The Government's application to the Supreme Court for permission to appeal was rejected in June 2019. The legal ruling around age discrimination also has implications for other pension schemes where they have implemented transitional arrangements on changing benefits, including the Local Government Pension Scheme (LGPS).</p> <p>In addition, the High Court ruled that defined benefit pension schemes must remove any discriminatory effect that guaranteed minimum pension entitlements have had on members benefits. GMPs must be equalised between men and women and past underpayments must be corrected. This will lead to increased costs for sponsors of defined benefit schemes (ie the LGPS) that were contracted out of the State Second Pension in the period from 17 May 1990 to 5 April 1997.</p> <p>These matters have been considered by the audit team. Management have agreed to adjust the accounts based on the revised IAS19 valuation report from the Actuary.</p>	<p>Our work identified material corrections to be made to the financial statements in respect of the McCloud judgment's impact on the pension liability. This matter was reported in our ISA 260 audit report.</p> <p>Aside from the above adjusted misstatement our audit has not identified any issues in respect of valuation of net pension liability.</p>

Audit of the Financial Statements

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>Management override of internal controls</p> <p>Under ISA (UK) 240 there is non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.</p> <p>We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk for both the group/Authority and Fund, which was one of the most significant assessed risks of material misstatement.</p>	<p>We have:</p> <ul style="list-style-type: none"> • evaluated the design effectiveness of management controls over journals; • analysed the journals listing and determined the criteria for selecting high risk unusual journals; • tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration by appropriate evidence; • gained an understanding of the accounting estimates and critical judgements applied by management in preparation of the accounts and considered their reasonableness with regard to corroborative evidence; and • evaluated the rationale for any changes in accounting policies or significant unusual transactions. 	<p>Our audit did not identify any issues in respect of management override of controls.</p>

Audit of the Financial Statements

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>Valuation of level 3 investments</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 have identified the valuation of Level 3 investments as a risk requiring special audit consideration.</p>	<p>We have:</p> <ul style="list-style-type: none"> gained an understanding of the Fund's process for valuing level 3 investments and evaluate the design of the associated controls; reviewed the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments; and for all investments, tested the valuation by obtaining and reviewing the audited accounts, (where available) at the latest date for individual investments and agreed these to the fund manager reports at that date. Reconciled those values to the values at 31 March 2019 with reference to known cash movements in the intervening period. 	<p>Our audit did not identify any issues in respect of level 3 investments.</p>
<p>Management override of controls</p> <p>Under ISA (UK) 240 there is non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.</p> <p>We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk for both the group/Authority and Fund, which was one of the most significant assessed risks of material misstatement.</p>	<p>We have:</p> <ul style="list-style-type: none"> Evaluated the design effectiveness of management controls over journals Analysed the journals listing and determine the criteria for selecting high risk unusual journals Tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration Gained an understanding of the accounting estimates and critical judgements applied made by management and considered their reasonableness with regard to corroborative evidence Evaluated the rationale for any changes in accounting policies or significant unusual transactions. 	<p>Our audit did not identify any issues in respect of management override of controls.</p>

Audit of the Financial Statements

Audit opinion

We gave an unqualified opinion on the group's financial statements on 31 July 2019.

We gave an unqualified opinion on the Pension Fund financial statements on 31 July 2019.

Preparation of the financial statements

The Council presented us with draft financial statements 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.

Issues arising from the audit of the financial statements

We reported the key issues from our audit to the Council's Audit & governance Committee on 29 July 2019.

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 in 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.

Pension fund accounts

We gave an unqualified opinion on the pension fund accounts of Surrey Pension fund on 31 July 2019. We also reported the key issues from our audit of the pension fund accounts to the Council's Audit & Governance Committee on 29 July 2019.

Whole of Government Accounts (WGA)

We are in the process of carrying out work on the Council's Data Collection Tool in line with instructions provided by the NAO for bodies above the audit threshold. We anticipate that we will issue our assurance statement in respect of this matter in early September 2019.

Other statutory powers

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.

No such powers have been exercised in respect of the audit for 2018/19.

Certificate of closure of the audit

We are unable to certify that we have completed the audit of the financial statements of Surrey County Council until we resolve the issues set out on page 4 relating to the review of the Pension Fund annual report and issue of WGA assurance statement.

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

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

The risks we identified and the work we performed are set out overleaf.

As part of our Audit Findings report agreed with the Council in July 2019, we agreed recommendations to address our findings.

Overall Value for Money conclusion

Because of the significance of the matters we identified in our work, we were not satisfied that the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2019.

Value for Money conclusion

Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Financial resilience</p> <p>In November 2018 we provided a report to the Council on Review of financial Health Arrangements. This review summarised the additional work we undertook to support our delayed VfM conclusion for 2017/18, specifically in regard to the Council's financial health. The review considered the significant financial challenges facing the Council and the implications for financial sustainability in the short to medium term.</p> <p>As noted in that report, the Council has taken robust steps to address the significant financial challenge that it faces. The Council's new senior management team acted promptly and effectively to strengthen arrangements to manage and deliver the planned savings. However, at the time of review further work was underway to develop savings and transformation plans to full business case stage so they could be implemented. We indicated that it would be important to track progress on delivering these over the medium term.</p>	<p>For the 2018/19 VfM conclusion, we have reviewed the progress made towards restoring financial sustainability since November 2018. We found that significant progress has been made and financial resilience has been improved, but there remains significant further work to do to achieve a sustainable financial position.</p>	<p>The Council's MTFS published in January 2019 projects a savings gap of £133.8m to be closed by 2023-24. This assumes that the second tranche of planned savings in its financial improvement programme deliver a further £82m by the end of 2019/20. The financial challenge therefore remains acute and it will be important that the momentum gained in 2018/19 is maintained. We will continue to monitor progress against savings target for 2019/20.</p>
<p>Eco Park PFI scheme</p> <p>The Gasification facility was due to be operation by 7 November 2017 and is not yet operations, so it is significantly delayed. The "longstop" date, which would allow the Council to terminate the contract without fault falls 18 months after the target completion date, so in respect of the facility was 7 May 2019. We understand that if the Council does not exercise its termination rights it retains the right to do so at a later date.</p> <p>Management have stated that the project delays to 31 March 2019 have been associated with the management of the construction project, not failure of the gasification technology. While the Council is aware that other facilities using similar technology have experienced reliability issues, the Eco Park has not yet reached the point of operation or commissioning.</p>	<p>The audit team have held discussions with management regarding the scheme and reviewed value for money analysis undertaken by the Council in October 2013 considered both the quantitative and qualitative aspects of proceeding with the contract variation for the development for the Eco Park.</p>	<p>Following project delays the Council updated its VfM assessment in April 2015. This assessment confirmed the earlier assessment that the development of the Eco Park remained the best value solution for the public.</p>
<p>Ofsted inspection</p> <p>In June 2015 Ofsted published a report on services for children in need of help and protection, children looked after and care leavers in Surrey, based on their inspection visit in November 2014. The overall judgement was that children's services were inadequate.</p> <p>Ofsted subsequently issued a follow-up inspection report in May 2018 based on their February 2018 inspection visit, in which the inadequate rating remained in place. Ofsted stated in the report that "Senior leaders and elected members in Surrey have been far too slow to accept and act on the findings and recommendations of the 2014 inspection, and to respond with the required urgency to the findings of several subsequent monitoring visits. Too many of the most vulnerable children in the county are being left exposed to continuing harm for long periods of time before decisive protective actions are taken".</p>	<p>Following the 2018 inspection report the Council had two monitoring visits from inspectors in September 2018 and January 2019. The audit team have reviewed the results of these inspections.</p>	<p>Overall during 2018/19 there remains evidence of weaknesses in proper arrangement for understanding and using appropriate and reliable financial and performance information to support informed decision making and performance management and planning, organising and developing the workforce effectively to deliver strategic priorities.</p>

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	Date issued
Audit Plan	8 April 2019
Audit Findings Report	23 July 2019
Annual Audit Letter	30 August 2019

Fees (excluding VAT)

	Planned £	Actual fees £	2017/18 fees £
Statutory audit – Surrey County Council & Pension Fund	130,286	151,786	169,203
Non-Audit fees:			
CFO Insights Subscription	12,500	12,500	12,500
Certification of Teachers' Pensions Returns (SCC and Surrey Choices)	7,500	7,500	7,500
Total fees	150,286	171,786	189,203

Audit fee variation

As outlined in our audit plan, the 2018-19 scale fee published by PSAA of £130,286 assumes that the scope of the audit does not significantly change. There are a number of areas where the scope of the audit has changed, which has led to additional work. These are set out in the following table.

All fee variations are subject to PSAA approval.

Area	Reason for variation	Fee proposed
Assessing the impact of the McCloud ruling	See description on page 7 of this report. As part of our audit we have reviewed the revised actuarial assessment of the impact on the financial statements along with any audit reporting requirements.	£3,000
Pensions – IAS 19	The Financial Reporting Council has highlighted that the quality of work by audit firms in respect of IAS 19 needs to improve across local government audits. Accordingly, we have increased the level of scope and coverage in respect of IAS 19 this year to reflect this.	£3,000
Pensions – IAS 19 letters	A number of local auditors in Surrey wrote to us as auditors of the Surrey County Council Pension Fund in order to request assurances in connection with their audits. Under the PSAA framework the costs of drafting and providing these assurances should be charged to the administering authority pension fund.	£5,000
PPE Valuation – work of experts	As above, the Financial Reporting Council has highlighted that auditors need to improve the quality of work on PPE valuations across the sector. We have increased the volume and scope of our audit work to reflect this.	£3,000
PPE Valuation – engagement of auditor's expert	As part of our work on the valuation of PPE we were required to engage our own valuers in respect of Surrey County Council's PPE valuations. We were also required to perform additional audit work to respond to the results of the valuer's work.	£5,000
PFI Eco Park work	The PFI Eco Park scheme required additional consideration as part of our audit, including the accounting and Value for Money implications of the scheme.	£2,500
Total		£21,500



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