Audit Findings

Year ending 31 March 2018

Somerset County Council

18 July 2018

Contents

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Headlines

This table summarises the key issues arising from the statutory audit of Somerset County Council ('the Council') and the preparation of the Council's financial statements for the year ended 31 March 2018 for those charged with governance.

Financial Statements	Under the International Standards of Auditing (UK) (ISAs), we are required to report whether, in our opinion: • the Council's financial statements give a true and fair view of the Council's financial position and of the group and Council's expenditure and income for the year, and • have been properly prepared in accordance with the CIPFA/LASAAC code of practice on local authority accounting and prepared in accordance with the Local Audit and Accountability Act 2014. We are also required to report whether other information published together with the audited financial statements (including the Statement of Accounts, Annual Governance Statement (AGS) and Narrative Report), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.	We commenced our post-statements onsite visit at the end of May and as at 18 July 2018 our audit is substantially complete. Our findings are summarised on pages 4 to 12. We have identified no material errors and no adjustments to the financial statements that have resulted in a adjustment to the year end outturn position or balance sheet. We have recommended a number of adjustments to improve the presentation of the financial statements. The draft financial statements were presented for audit in accordance with the earlier timetable of the end of May 2018. The accounts were supported by good quality working papers and we received prompt responses to our queries. Audit adjustments are detailed in Appendix C. Our follow up of recommendations from the prior year's audit are detailed in Appendix B. Subject to outstanding queries being resolved, we anticipate issuing an unqualified audit opinion following the Audit Committee meeting on 26 July 2018, as detailed in Appendix E. These outstanding items are set out on slide 4. We have concluded that the other information published with the financial statements, which includes the Statement of Accounts, Annual Governance Statement and Narrative Report, are consistent our knowledge of your organisation and with the financial statements we have audited.
Value for Money arrangements	Under the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report whether, in our opinion: • the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources ('the value for money (VFM) conclusion')	We have completed our risk based review of the Council's value for money arrangements. Our work on Strategic Financial Planning has concluded that the Council does not have proper arrangements in place to ensure sustainable resource deployment. We therefore anticipate issuing a qualified 'adverse' value for money conclusion, concluding that the Council does not have proper arrangements to secure economy, efficiency and effectiveness in its use of resources. Our findings are summarised on pages 13 to 28 and our qualified value for money conclusion is detailed in Appendix E. We have made a number of recommendations for management as a result of our value for money audit work in Appendix A.
Statutory duties	The Local Audit and Accountability Act 2014 ('the Act') also requires us to: • report to you if we have applied any of the additional powers and duties ascribed to us under the Act; and • certify the closure of the audit	We have not exercised any of our additional statutory powers or duties. We have completed the majority of work under the Code and we do not expect to be able to certify the conclusion of the audit as we have yet to complete the work required under the Whole of Government Account review which will take place in August 2018.

Acknowledgements

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

Summary

Overview of the scope of our audit

This Audit Findings Report presents the observations arising from the audit that are significant to the responsibility of those charged with governance (in the case of Somerset County Council, the Audit Committee) to oversee the financial reporting process, as required by International Standard on Auditing (UK) 260 and the Code of Audit Practice ('the Code'). Its contents have been discussed with management.

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

Audit approach

Our audit approach was based on a thorough understanding of the Council's business and is risk based, and in particular included:

- An evaluation of the Council's internal controls environment including its IT systems and controls; and
- Substantive testing on significant transactions and material account balances, including the procedures outlined in this report in relation to the key audit risks

Conclusion

We have substantially completed our audit of your financial statements and subject to outstanding queries being resolved, we anticipate issuing an unqualified audit opinion following the Audit Committee meeting on 26 July 2018, as detailed in Appendix E. These outstanding items include:

- Receipt of management representation letter;
- Final review of the audit work
- Completion of the Whole of Government Accounts work; and
- Review of the final set of financial statements.
- Third party confirmation for a small number of investments

Our approach to materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law.

Materiality calculations remains the same as reported in our audit plan. We detail in the table below our assessment of materiality for Somerset County Council.

	Council Amount (£)	Qualitative factors considered
Materiality for the financial statements	15,100,000	This equates to 1.8% of your prior year expenditure. The change in overall expenditure in 2017/18 is not sufficient to require a change to the overall materiality
Performance materiality	11,325,000	This equates to 75% of Materiality. 75% is the maximum we are able to apply and we have not changed this due to knowledge of the client and few issues being noted in prior years
Trivial matters	755,000	ISA260 (UK) defines 'clearly trivial' as matters that are clearly inconsequential whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria
Materiality for specific transactions, balances or disclosures	5,000	Senior Officers' Remuneration and Related Party Transactions are balances which require a lower materiality due to the sensitive nature of these balances

Going concern

Our responsibility

As auditors, we are required to “obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern” (ISA (UK) 570).

Going concern commentary

Management's assessment process	Auditor commentary
Management have a reasonable expectation that the services provided by the Council will continue for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements	• The disclosures in the accounts are considered appropriate • We have reviewed the Council’s Medium Term Financial Plan (MTFP) and the assumptions within. • We have reviewed the Council’s four year funding agreement as assurance of income • We have reviewed the Council’s financial plans for 2018/19 including the requirement to achieve savings.
Work performed	**Auditor commentary**
We have reviewed the Chief Finance Officer’s assessment and the MTFP. We have reviewed the associated disclosures in the financial statements	• Management set out their consideration of the appropriateness of the adoption of going concern assumption in a specific report provided to the auditor in July 2018. In this report the Chief Finance officer confirmed his view that the Council is a going concern. Subsequently the Chief Finance Officer also confirmed that there are no material uncertainties that would require disclosure, under ISA 570. We concur with this view. • Disclosures in the financial statements relating to material uncertainties are appropriate and sufficient.
Concluding comments	**Auditor commentary**
We are satisfied that the Going Concern basis is appropriate for the 2017/18 financial statements	• Our audit opinion will be unmodified in respect of Going Concern

Significant audit risks

Risks identified in our Audit Plan	Commentary
Improper revenue recognition Under ISA 240 (UK) 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.	**Auditor commentary** Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Council, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited • The culture and ethical frameworks of local authorities, including Somerset County Council, mean that all forms of fraud are seen as unacceptable Therefore we do not consider this to be a significant risk for Somerset County Council.
Management override of controls 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. The Council faces external scrutiny of its spending, and this could potentially place management under undue pressure in terms of how they report performance. We identified management override of controls as a risk requiring special audit consideration.	**Auditor commentary** We have performed the following work in respect of this risk – Gained an understanding of the accounting estimates, judgements and decisions made by management and consider their reasonableness – Obtained a full listing of journal entries, identified and tested unusual journal entries for appropriateness – Carried out a review of accounting estimates, judgements and decisions made by management – review of unusual significant transactions – review of significant related party transactions outside the normal course of business Our audit work has not identified any issues in respect of management override of controls with the exception of the Council's policy not including a requirement for a second authoriser. A recommendation has been included in the action plan.

Significant audit risks

Risks identified in our Audit Plan	Commentary
Valuation of property, plant and equipment The Council revalues its land and buildings on a rolling basis to ensure that the carrying value is not materially different from fair value. This represents a significant estimate by management in the financial statements. We identified the valuation of land and buildings and impairments as a risk requiring special audit consideration	**Auditor commentary** We have performed the following work in respect of this risk • Reviewed management's processes and assumptions for the calculation of the estimates • Reviewed the competence, expertise and objectivity of any management expert used • Reviewed the instructions issued to valuation experts and the scope of their work • Held discussions with the Council's valuers about the basis on which the valuation was carried out, challenging the key assumptions • Reviewed and challenged the information used by the valuer to ensure it was robust and consistent with our understanding • Tested revaluations made during the year to ensure they were input correctly into the Council's asset register • Evaluated 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 the current value Our audit work has not identified any issues in respect of valuation of property plant and equipment.
Valuation of pension fund net liability The Council's pension fund asset and liability as reflected in its balance sheet represent a significant estimate in the financial statements. We identified the valuation of the pension fund net liability as a risk requiring special audit consideration	**Auditor commentary** We have performed the following work in respect of this risk • Identified the controls put in place by management to ensure that the pension fund net liability is not materially misstated and assessed whether those controls were implemented as expected and whether they were sufficient to mitigate the risk of material misstatement. • Reviewed the competence, expertise and objectivity of the actuary who carried out the Council's pension fund valuation. • 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. • Reviewed of the consistency of the pension fund net liability disclosures in notes to the financial statements with the actuarial report from your actuary. Our audit work has not identified any issues in respect of the valuation of the pension fund net liability.

Reasonably possible audit risks

Risks identified in our Audit Plan	Commentary
Employee remuneration Payroll expenditure represents a significant percentage of the Council's operating expenses. As the payroll expenditure comes from a number of individual transactions there is a risk that payroll expenditure in the accounts could be understated. We therefore identified completeness of payroll expenses as a risk requiring particular audit attention.	**Auditor commentary** We have undertaken the following work in relation to this risk: • documented our understanding of processes and key controls over the transaction cycle • undertaken walkthrough of the key controls to assess the whether those controls were in line with our documented understanding • Agreed the year-end payroll reconciliation and ensured the amount disclosed in the accounts can be reconciled to the ledger and through to payroll reports • Agreed payroll related accruals to supporting documentation and reviewed any estimates for reasonableness Our audit work has not identified any issues in respect of employee remuneration
Operating expenses Non-pay expenses on other goods and services also represents a significant percentage of the Council's operating expenses. Management uses judgement to estimate accruals of un-invoiced costs. We identified completeness of non- pay expenses as a risk requiring particular audit attention:	**Auditor commentary** We have undertaken the following work in relation to this risk • evaluated the Council's accounting policy for recognition of non-pay expenditure for appropriateness; • gained an understanding of the Council's system for accounting for non-pay expenditure and evaluate the design of the associated controls; • Documented the accruals process and the controls management have put in place. Challenged key underlying assumptions, the appropriateness of the source data used and the basis for calculations • Reviewed a sample of non-pay payments made post year end to ensure that they have been charged to the appropriate financial period Our audit work has not identified any issues in respect of operating expenditure

Other issues

This section provides commentary on new issues and risks which were identified during the course of the audit that were not previously communicated in the Audit Plan.

Issue	Commentary	
Group accounts The Council has TUPEd 1300 staff members to Discovery who are responsible for the provision of adult social care services within Somerset. Given the cost of the contract and the service provided discussions have been held as to whether this requires the disclosure of group accounts or not.	• The Council's view is that there is no direct control operated over the actions of Discovery and therefore group accounts are not required. • Management set out their consideration of the need to produce group accounts in light of the agreed contract with Discovery and based on the fact that they are, currently, the only customers. Management have considered that the absence of control means no group accounts disclosures are required • The Council will continue to monitor this position on an annual basis to see if the position changes.	**Auditor view** • We have reviewed the Group structure of the Council; • We have reviewed Management's assertions over whether there is a requirement for group account disclosures on both a qualitative and quantitative basis • We have reviewed the agreement with Discovery and noted that there is no Council representation on the Board or within the governance structure of Discovery. Having considered the Council's assessment we concur with the Council's view that consolidated accounts are not required for 2017/18 as there is no direct control by the Council and they are unable to influence the strategic direction of Discovery.
Lender Option Borrowing Options (LOBOs) The Council has a number of LOBOs (a type of longer term borrowing where the lender can change terms), and this area is subject to increased attention by auditors due to the complexities valuing these in a more complex form.	• We have considered the LOBOs held by the Council, including the accounting treatment of these, and whether the Council hold any non-standard LOBOs which may result in material changes to the values in the accounts.	**Auditor view** • We have not identified any non-standard LOBOs held by the Council. • We have not identified any significant issues with the accounting treatment of the standard LOBOs held by the Council.

Accounting policies

Accounting area	Summary of policy	Comments	Assessment
Revenue recognition	• Activity is accounted for in the year that it takes place, not simply when cash payments are made or received • This covers all material sources of revenue	• The accounting policy is appropriate and complies with the Code of Practice on Local Authority Accounting (the Code) • Income is not an area that requires significant judgement or estimation	G
Judgements and estimates	• Key estimates and judgements include: – Depreciation – Useful life of PPE – Revaluations – Impairments – Accruals – Valuation of pension fund net liability – Provision for NNDR appeals – Other provisions – PFI and similar arrangements	We have reviewed the accounting areas where the Council has exercised judgement and used estimates. We found that: • Appropriate policies had been used • Accounting policies had been adequately disclosed • Areas where judgement had been used were supported by an expert of third party	G
Other critical policies		We have reviewed the Council's policies against the requirements of the CIPFA Code of Practice. The Council's accounting policies are appropriate and consistent with previous years.	G

Assessment
- Marginal accounting policy which could potentially be open to challenge by regulators
- Accounting policy appropriate but scope for improved disclosure
- Accounting policy appropriate and disclosures sufficient

Other communication requirements

We set out below details of other matters which we, as auditors, are required by auditing standards and the Code to communicate to those charged with governance.

Issue	Commentary
Matters in relation to fraud	• We discussed matters in relation to fraud in our communications with management and the Audit Committee. We are aware that a number of frauds have been included within reporting to Audit Committee and actions are in place to address these. No other issues have been identified during the course of our audit procedures
Matters in relation to related parties	• We are not aware of any related parties or related party transactions which have not been disclosed
Matters in relation to laws and regulations	• You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations. With the exception of the areas identified in our review of your compliance with the Capital Flexibilities Direction (pages 19-20) we have not identified any incidences from our audit work.
Written representations	• A standard letter of representation has been requested from the Council, which is included in the Audit Committee papers
Confirmation requests from third parties	• We requested from management permission to send confirmation requests to the bodies with which the Council hold investment, cash and debt balances. This permission was granted and the requests were sent. The majority of these requests were returned with positive confirmation, however a small number have not as yet been received. If these are not forthcoming we will look to undertook alternative procedures. • We requested from management permission to send confirmation requests to the pension fund auditor. This permission was granted and the requests were sent. We have not yet received the final response from the pension fund auditor and will require this prior to issuing our opinion.
Disclosures	• Our review found no material omissions in the financial statements • A number of minor disclosure changes were proposed throughout the statement of accounts, the Annual Governance Statement and the Narrative Report
Significant difficulties	• We did not experience any significant difficulties during the course of the opinion audit

Other responsibilities under the Code

We set out below details of other matters which we, as auditors, are required by the Code to communicate to those charged with governance.

Issue	Commentary
Other information	• We are required to give an opinion on whether the other information published together with the audited financial statements (including the Statement of Accounts, Annual Governance Statement (AGS) and Narrative Report, is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. We have seen the updated AGS reflecting our proposed VFM conclusion. No inconsistencies have been identified. We plan to issue an unqualified opinion in this respect – refer to appendix E
Matters on which we report by exception	We are required to report on a number of matters by exception in a numbers of areas: • If the Annual Governance Statement does not meet the disclosure requirements set out in the CIPFA/SOLACE guidance or is misleading or inconsistent with the other information of which we are aware from our audit • If we have applied any of our statutory powers or duties We have nothing to report on these matters
Specified procedures for Whole of Government Accounts	We are required to carry out specified procedures (on behalf of the NAO) on the Whole of Government Accounts (WGA) consolidation pack under WGA group audit instructions. As the Council exceeds the specified group reporting threshold of £500m we examine and report on the consistency of the WGA consolidation pack with the Council's audited financial statements. • Note that work is not yet completed and the planned timescale for the work is for completion by the deadline of 31 August 2018
Certification of the closure of the audit	We do not expect to be able to certify the completion of the 2017/18 audit of Somerset County Council in our auditor's report, as detailed in Appendix E, until we have completed Specified procedures for Whole of Government Accounts by the end of August 2018.

Value for Money

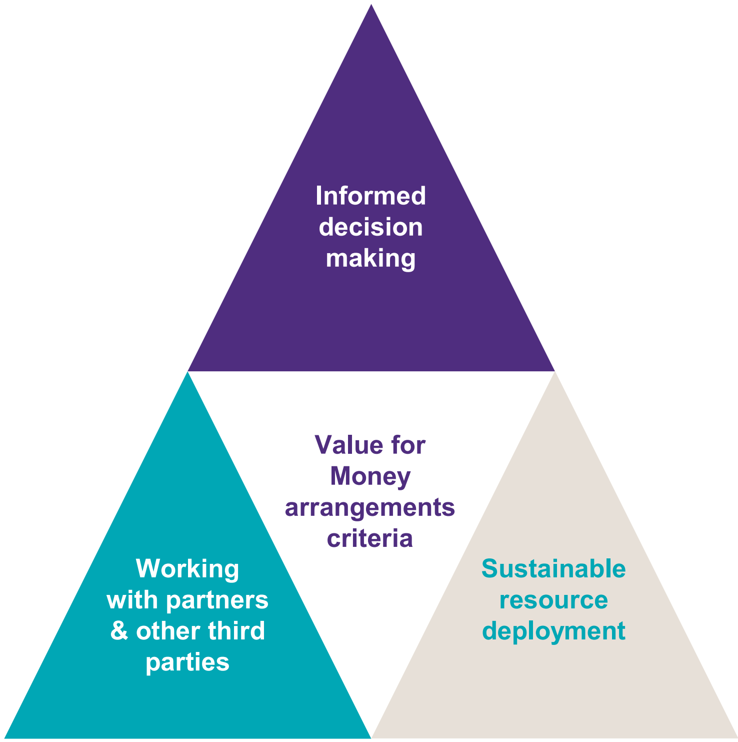
Background to our VFM approach

The NAO issued its guidance for auditors on Value for Money work for 2017/18 in November 2017. The guidance states that for local government bodies, auditors are required to give a conclusion on whether the Council has proper arrangements in place.

The guidance identifies one single 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."

This is supported by three sub-criteria, as set out below:



Risk assessment

We carried out an initial risk assessment in December 2017 and identified a number of significant risks in respect of specific areas of proper arrangements using the guidance contained in AGN03. We communicated these risks to you in our Audit Plan dated 15 January 2018.

We have continued our review of relevant documents up to the date of giving our report, and although we have not identified any further significant risks where we need to perform further work, we have undertaken additional work in the risk area of Strategic Financial Planning.

We carried out further work only in respect of the significant risks we identified from our initial and ongoing risk assessment. Where our consideration of the significant risks determined that arrangements were not operating effectively, we have used the examples of proper arrangements from AGN 03 to explain the gaps in proper arrangements that we have reported in our VFM conclusion.

Value for Money

Our work

AGN 03 requires us to disclose our views on significant qualitative aspects of the Council's arrangements for delivering economy, efficiency and effectiveness.

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

Strategic Financial Planning

- Whether budget setting is sufficiently robust to set a realistic and achievable budget having regard to the prior period outturn and requirements of demand led services
- Consistency between the budget and internal financial monitoring, facilitating challenge and corrective action where overspends are identified
- Ability of members to sufficiently challenge and hold service leads to account based on the information provided
- Challenge provided by the Senior Leadership Team to overspends and failure to meet savings targets
- Arrangements for identifying and monitoring savings including consistency of reporting by theme and service line

Children's services

- The findings of the Ofsted report showing that improvements have been made in the delivery of children's services. This has been reviewed in light of the overspend and whether processes are in place to continue delivering improved services

Additional work and additional fee

Our coverage under Strategic Financial Planning has been expanded, based on our updated assessment of risk, to include a deeper dive of the Council's arrangements for delivering its 2017/18 savings, the robustness of the 2018/19 budget, compliance with the Capital Flexibilities Direction, the clarity of internal financial reporting and the effectiveness of officer and member financial challenge and oversight. This resulted in us needing to spend additional resources to complete the value for money audit and as a result an additional fee will be levied.

We have set out more detail on the risks we identified, the results of the work we performed and the conclusions we drew from this work on pages 15 to 28.

Overall conclusion

We have completed our risk based review of the Council's value for money arrangements. Our work on Strategic Financial Planning has concluded that the Council does not have proper arrangements in place to ensure sustainable resource deployment. We therefore anticipate issuing a qualified 'adverse' value for money conclusion, concluding that the Council does not have proper arrangements to secure economy, efficiency and effectiveness in its use of resources.
Our qualified value for money conclusion is detailed in Appendix E.

Recommendations for improvement

We discussed findings arising from our work with management and have agreed recommendation for improvement.

Detailed on our recommendations can be found in the Action Plan at Appendix A

In reaching our conclusion we look only at those arrangements and processes in place for 2017/18. We recognise that the Council have taken a number of steps to begin to address these issues and that financial scrutiny is now at the centre of the Council's strategy. This has fed into Senior Leadership Team meetings and is top of the agenda from a member scrutiny point of view.

Significant difficulties in undertaking our work

We did not identify any significant difficulties in undertaking our work on your arrangements which we wish to draw to your attention.

Significant matters discussed with management

There were no matters where no other evidence was available or matters of such significance to our conclusion or that we required written representation from management or those charged with governance.

Key findings

We set out below our key findings against the significant risks we identified through our initial risk assessment and further risks identified through our ongoing review of documents.

Significant risk -Strategic Financial Planning

We reported in our audit plan that the ongoing challenge of meeting the savings outlined by Central Government continue to put pressures on Local Government finances. The delivery of the financial strategy is currently reliant on transformational change, significant savings in service delivery and increased income activity. The continued pressure from Adult and Children's services has resulted in overspends annually and further enforces the need to identify alternative methods of achieving the Council's financial position for the future.

We said we would review the project management and assurance frameworks established by the Council to understand how it is identifying, managing and monitoring these financial risks. We will review the robustness of the Council's financial plan and the extent to which the Council is seeking to identify further opportunities and alternative solutions to mitigate the risk of future cuts in resources and government funding. Our review will look at the delivery of the 2017/18 budget, including savings targets, as well as considering the robustness of the MTFP.

Overall Conclusion

The council's financial health has deteriorated over the last 12 months due to continued overspending, predominantly in the area of children and families. This has necessitated further use of already depleted reserves that now means the council has limited capacity to fund any further overspending. The inability of the council to deliver against its budget is now pervasive to the whole council and without urgent actions could result in it running out of money in the next two to three years. Further effort is now required to ensure budgets are delivered and the council repositions itself on a sustainable financial footing. To facilitate this, arrangements for budget setting, internal budget monitoring and internal financial reporting need improving to ensure consistency of reports that contain the appropriate level of detail to ensure challenge takes place and decisions are taken based on complete and accurate information.

In light of this conclusion above, we are unable to state that Somerset County Council has proper arrangements in place to ensure sustainable resource deployment because we believe this has now become pervasive to the effective functioning of the whole council. As a result, we propose to issue an adverse 2017/18 value for money conclusion.

We have made a number of recommendations within this report and have also considered the need to exercise our wider auditor powers. At this stage, we have decided not to exercise these powers, but will consider the need to issue a 'statutory recommendation' under section 24 (Schedule 7) of the Local Audit and Accountability Act, should arrangements at the council not improve and/or further significant overspends emerge during the course of 2018/19.

Detailed Findings

2016/17 Audit report

In our 2016/17 Audit Findings Report, we highlighted that the council's combined level of general fund reserves and other earmarked reserves had fallen significantly over recent years. We said that this trend was clearly not sustainable over the medium term and that the council's medium term financial plans could not continue to draw on reserves. We identified the need for close in year monitoring and timely corrective action to ensure budgets are delivered and service redesign implemented.

Other assurance reports

Over the last 12 months, the financial position at Somerset County Council has increasingly come under the spotlight. The LGA 'Corporate Peer Challenge' feedback report issued in March 2018 highlighted '*that if the level of overspending seen in 2017/18 continues in 2018/19, SCC will only have sufficient resources to balance its budget for one more year*'. A further report by the council's Internal Auditor on the 'Medium Term Financial Plan (MTFP) – The Commissioning Driven Approach' presented to Audit Committee in June 2018 highlighted that the council's *'revised (Commissioning led) approach is failing to meet the savings targets set.'*

Our findings

Our work in this area has had regard to these reports in assessing the council's arrangements for budget setting, monitoring and reporting as well as reaching a conclusion on its financial health. Our work has also been expanded, based on our updated assessment of risk, to include a deeper dive of the council's arrangements for delivering its 2017/18 savings, the robustness of the 2018/19 budget, compliance with the Capital Flexibilities Direction, the clarity of internal financial reporting and the effectiveness of officer and member financial challenge and oversight. Our work has included ongoing discussions with key finance officers, detailed reviews of financial plans and engagement with members in the run up to us reaching our conclusion.

Our detailed findings are set out below:

2017/18 budget setting

At the 31 March 2017, the audited accounts reported a General Fund balance of £20.2m and General Fund earmarked reserves of £8.1m.
At Full Council in February 2017 the then S151 officer reported in his annual '*Report on the Robustness of the 2017/18 estimates and the adequacy of reserves and balances'* assessment, that in his view *'based on the assessment of reserves, contingencies and balances, the key financial risks identified, and the thorough process used for developing the Medium Term Financial Plan, I have determined that the level of reserves, contingencies and balances for the 2017/18 financial year are adequate'.* His report went on to say that the council *'have tried to keep a minimum of £15m in the General Fund Reserve'.*

As set out above, at the start of the 2017/18 financial year the General Fund balance was in excess of this minimum. No specific comments were made in this report as to why the level of earmarked or other reserves were considered adequate.

At the same meeting, the council set a net revenue budget for 2017/18 of £311.8m. This included a net contribution of £1.0m for 'contribution to/from reserves, capitalisation flexibility and Capital fund', although the split between these sources of funding was not detailed. The February 2017 full council paper acknowledged pressures in service areas but commented that '*the expectation (is) that services will continue to absorb the pressures relating to inflation and democratic demands'*, therefore no additional funding was provided in respect of these. The overall net budget requirement for 2017/18 of £311.8m represents a small (0.3%) reduction in budgeted net revenue expenditure when compared with the previous year (£312.3m). In the 'demand lead' areas of children and families and adults and health, although not detailed in the original budget papers submitted to council, the funding reduced from £70.3m to £66.8m for children and families and increased from £133.3m to £136.7m adults and health (including Learning Disabilities) from 2016/17 to 2017/18.

The increase in the adults and health budget was funded, in part, through the maximum permitted increase in Council Tax for social care funding of 2%, resulting in an overall Council Tax increase of 3.99% for the 2017/18 financial year.

This budget was predicated on the delivery of £18.1m of in-year savings, subsequently increased to £19.5m when the previous year savings slippage was added (6.2% of the net budget). The savings were categorised, in the cabinet report, at this budget setting stage on a thematic basis, but were, according to officers, built into the directorate base line budgets. Although not evident from the February 2017 council budget papers, the budget included an unallocated contingency of £10.1m that was to be used to finance possible pressures arising in year. This contingency forms part of the £21.2m of 'Non Service items (including Debt Charges)' included in subsequent budget in-year monitoring reports.

The setting aside of a contingency is often used to facilitate the delivery of service line budgets, but can make the original service line budget unachievable and disincentives delivery. Experience suggests such a large contingency, when considered alongside the historic overspends and reduction in funding may render some of the original service budgets unrealistic.

2017/18 financial monitoring

Formal monitoring of delivery against budget is through planned, periodical reporting to cabinet and Senior Leadership Team (SLT). There was early identification of pressures on the 2017/18 budget with the month 2 report to Cabinet projecting an overspend of £8.7m after the use of £10.5m in reserves. This timely reporting was supplemented with further updates at quarters 2, 3 and outturn.

The ability of the cabinet members to effectively challenge financial performance and savings is, in our view, restricted by the inconsistent format of reporting between budget setting and monitoring, combined with a large number of adjustments to the baseline service figures. For example, the month 2 monitoring report introduces the use of earmarked reserves and grants of £10.6m to reduce projected overspends, recognising the total earmarked reserve balance at 31 March 2017 totalled only £8.1m. The monitoring report also separately, for the first time, reported the proposed used of Capital Flexibilities which at month 2 totaled £1.5m.

It is our view, that the ability to gain a clearer understanding of the financial position was further compounded by the crucial savings target of £19.5m being incorporated into the service lines with no position statement against this delivery in year in total or against the original thematic headings. In order to remain financially viable councils can no longer top slice service line budget but require transformational, stepped change in the way services are provided to deliver the savings required. Thematic savings targets do work but they need to be effectively monitored against the original detailed budget figures on a like for like basis.

Internal Audit's report commented on the *'arbitrary'* nature of the targets, with *'little supporting evidence'* as to how these would be achieved. Ownership was assessed as being *'poorly defined across the themes'* with governance structures not providing challenge.

Our review indicates that although a large number of the smaller savings schemes were delivered in 2017/18, overall achievement of the savings target in year was adversely impacted by the failed delivery of the high value schemes. Specifically, as set out in the table below, for three programmes with a total savings target of £13.5m only £5.6m was realised in year.

Service Line	Savings Target	Realised	Unrealised
Learning Disabilities	£4,733,800	£175,800	£4,558,000
Children and Learning	£3,095,600	£1,142,800	£1,952,800
Commercial and Business Services	£5,677,600	£4,318,300	£1,359,300
TOTAL	£13,507,000	£5,636,900	£7,840,100

The Learning Disabilities savings programme, included within the service redesign theme, sought to deliver £4.7m of savings in 2017/18 but the year end savings only totaled £0.2m. The latest available reporting of savings delivery to Cabinet, in February 2018, indicated a projected delivery of £1.6m, but on further investigation this was un-intentionally misreported. Our deep dive into the reasons for this slippage suggests that savings targets were unrealistic and that the challenges of implementing a new delivery model had not been fully considered leading to greater challenges than originally anticipated. The new delivery model is predicated on managing demand through the delivery of the service at the same unit cost but with significantly less time per client. This scheme now forms a large part of the savings plan in 2018/19.

The two other large schemes within Children and Learning and Commercial and Business Services, equating to £8.8m, with a reported delivery of £5.6m, were also taken into account in the forward budget process.

As a result, only £11.1m (57%) of the budgeted £19.5m of savings were delivered in 2017/18. The last reporting of total savings to Cabinet was at February 2018, and on a service line basis. No year-end outturn savings position has been reported against the original thematic basis and therefore it is not possible to identify which of the thematic savings approaches have been a success.

Early on in 2017/18, the pressure on the children and families budget emerged. At month 2 the council was reporting a £14.5m overspend in this area, offset by £1.0m from reserves, but we have not seen any evidence as to what action was agreed or taken to bring this service line back in line. This failure was compounded by an acknowledgement of a clear lack of ownership and accountability for its delivery and based on our review, little evidence of challenge during the year as to why this was not being realised.

Although not present at SLT or cabinet, our review of the minutes of both indicates limited evidence of agreed actions to address the emerging overspends, particularly in the area of children and families. We recognise that a ‘closed cabinet’ meeting takes place every Monday and from our discussion with members we understand that finance is the main topic of discussion at this meeting. We also understand that cabinet and SLT meet bi-weekly and this is becoming increasingly focused on the financial challenges. Since the start of May 2018 each SLT meeting is now exclusively focused on finance. In our view budget monitoring arrangements for 2017/18 were ineffective.

In 2016/17, the Government introduced, and encouraged councils, to use a new Capital Flexibilities facility. This allows councils to use capital to fund revenue spend when it is incurred in transformation projects. The council used this flexibility in 2017/18 to finance £4.0m of expenditure. In order to utilise this flexibility, the council needs to demonstrate that the expenditure meets the definition in paragraph 3 of the Capital Flexibilities Direction. Requirements include the need for a published a strategy which is approved by council before the start of the relevant financial year and available publicly. The strategy should clearly signpost where expenditure will be incurred on a project by project basis and demonstrate that these are transformational in nature. Further, where the use of flexibilities has continued through a number of financial years the strategy needs to show what savings were realised against the approved projects from the prior year.

It is considered that a number of the requirements in 2017/18 have not been complied with as set out below:

- Presentation and approval of the Strategy by council, or equivalent, before the commencement of the financial year
- A consideration on a project by project basis and details of expected savings
- Reporting on the impact on the council's Prudential Indicators
- An analysis of previously approved projects and commentary on whether the planned savings or service transformation have been realised.

The council has, in our opinion, complied with the spirit of the requirements for qualifying expenditure, transformational projects, funded from in year capital receipts and as such has met the mandate of the directions. However, the council's budget setting and monitoring arrangements have not been robust enough to ensure compliance with the directions.

2017/18 outturn

The 2017/18 outturn paper to Cabinet of 11 June 2018 reported a £2.2m overspend (0.70% of budget) when compared to the revenue budget. This was achieved after a number of revisions to the original budget and in year use of reserves. The overspend was also reduced through the £4.0m of 'capital flexibilities' that were not included in the original budget approved in Feb 2017 and that increased from the reported position of £1.5m in month 2.

In order to assess the underlying position the outturn needs to be compared with the original budget and prior to the use of unplanned transfers. Earmarked reserves by definition are set aside for specific purpose or a particular service or type of expenditure. As a result, they may be called on in year even if not included within the original budget. At Somerset, however, these reserves appear to be being used in an unplanned way to reduce any overspend. For example, a £4.9m Learning Disabilities equalisation reserve was utilised in 2017/18 despite there being no opening balance. This has been reported in the statement of accounts as a debit and has reduced the overall earmarked reserves by £4.9m. Earmarked reserves further include directorate budget carry forwards as a debit balance of £7.1m. The net impact is to reduce total earmarked reserves at 31 March 2018 to £2.8m, made up of almost 40 different reserves some of which, as set out above, are negative. It is the practice of the council that service line overspends from the previous year are held as negative earmarked reserves and then reversed out through the general fund in the following financial year.

Therefore, we have reviewed General Fund reserves and Earmarked reserves together, given the close relationship between the two, to form an opinion on the adequacy of these reserves. The total of these two reserves, available to the council at 31 March 2018, is £23.7m which will not be sufficient into the medium term should the current levels of overspends continue.

2017/18 outturn continued

Total overspends before use of capital flexibilities are reported in the outturn report to Cabinet in June 2018 at table 1 as £7.1m. The gross overspend on key services was £14.5m which has been offset by £6.8m transfer from earmarked reserves, including the £4.9m for Learning Disabilities as set out above. It is not clear what the adjustment to key services budgets are as the 2017/18 budget was reported as a single entry so comparison to original budget is not possible. It is also considered that earmarked reserves have been used to reduce the level of overspend in year. We believe the headline £2.2m overspend for 2017/18 widely reported understates the underlying overspend in year.

The overspend in the budget has been well publicised as being due to the overspend in children and families. The 2017/18 children and families overspend is reported as £9.7m in the outturn report. However, this was only after the £2.3m use of reserves and contingency. The LGA Peer review, undertaken before year end, highlighted that ‘the council is forecast to overspend £14.5m in children’s social care services’ in 2017/18’. The evidence we have seen suggests that this estimate is much closer to the underlying position. Once one-off use of reserves are added back in the overspend is close to £12m (16% of the original budget). The fact that children and families have been rated as ‘inadequate’ for the last 3 years has impacted on the ability of the council to reduce spend. Services rated as ‘inadequate’ often overspend but this is not a given and it is not unreasonable to expect a council to address quality concerns whilst delivering against budget. Whether the problem in children and families is an unrealistic initial budget or poor in year financial management or a combination of both is unclear, but unless this is controlled going forward further overspends will arise leading to the need to utilise more of the depleted reserves or cut services elsewhere.

In contrast to children and families, the adults and health budget delivery has been a resounding success in 2017/18. Prior year overspends have been addressed and this area reported an underspend in year. It was noted from conversations with management that a key component in this recovery has been a much tighter control of expenditure with approvals required at all levels before that expenditure can be incurred.

Balances and Reserves at 31 March 2018

The net impact of the overspend in 2017/18 is to reduce the total level of usable reserves. The table below sets out the movements in these key reserves over the last few years. General Fund balances have increased marginally but the level of earmarked reserves now stands at only £2.8m a very small fraction of the level of such reserves we see at other similar sized councils (see table below). We recognise that some of the earmarked reserves held in previous years were for specific purposes such as 'flood recovery' work which has now been delivered, but the remaining balances provide for very little provision for future costs that other county councils deem necessary to provide for.

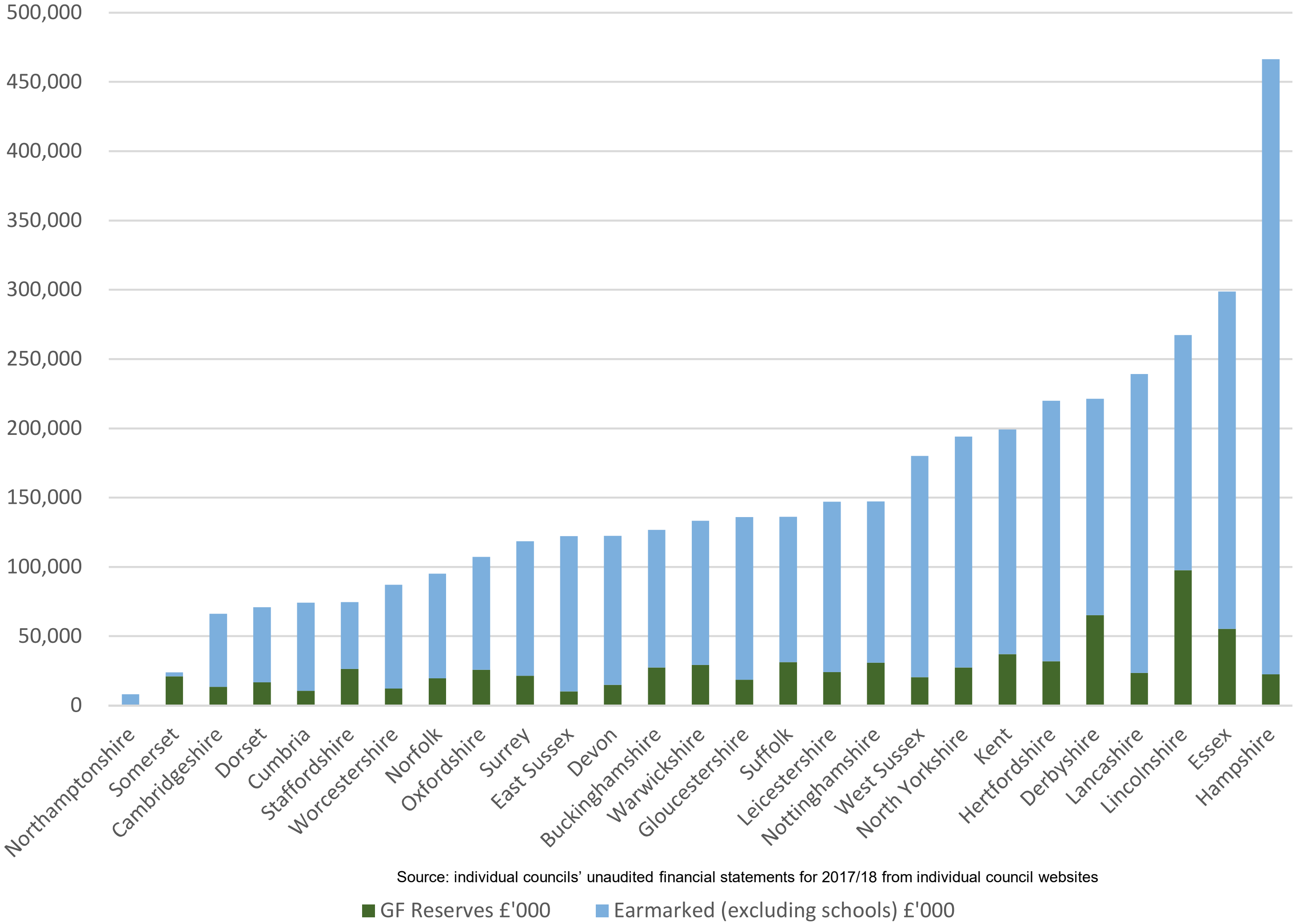
Year	General Fund (£m)	Earmarked (£m)	Schools (£m)
31 March 2015	£23.4	£57.0	£25.7
31 March 2016	£21.0	£37.5	£25.5
31 March 2017	£20.2	£8.1	£21.3
31 March 2018	£20.9	£2.8	£19.1

Source: audited and draft (2017/18) accounts for Somerset County Council

Balances and Reserves at 31 March 2018

The graph below sets out the combined level of general fund and earmarked reserves (excluding school balances) for each of the 27 county councils in England. This indicates that Somerset County Council has lower levels of earmarked reserves than any other county council and is therefore heavily reliant on its general fund balance to cover any unplanned spending.

2017/18 General Fund and Earmarked Reserves by county council



Source: individual councils' unaudited financial statements for 2017/18 from individual council websites

Balances and Reserves at 31 March 2018 continued

The council's general fund balance at 31 March 2018 reported in the draft financial statements, as set out in the previous graph, differs from the outturn report to Cabinet in June 2018. Table 1 of the cabinet report states, although the adjustments make it very difficult to follow, a balance of just £12.2m at 31 March 2018. This highlights again the confusing nature of the respective internal and external financial reporting. In our view this restricts the ability of members to follow the financial reports and therefore to challenge and hold officers to account.

The earmarked reserves totaling £2.8m at 31 March 2018, is made up of some 40+ individual reserves and hides the fact that within this figure are four large negative reserves totaling £20.0m. This suggests that if any of the larger positive reserves were required (in accordance with why they were set up) there would not be sufficient earmarked reserves to finance this. For example, at the June 2018 Audit Committee, a paper was taken on insurances and referred to an insurance reserve of £2.9m. There is such a reserve but total earmarked reserves at the 31 March 2018 are less than just this one reserve. As a result General Fund reserves would need to be called on in such an event.

At Full Council in February 2018, the then S151 office reported in his annual *'Report on the Robustness of the 2018/19 estimates and the adequacy of reserves and balances' assessment,* that in his view His report went on to say that the council*'based on the assessment of reserves, contingencies and balances, the key financial risks identified, and the thorough process used for developing the Medium Term Financial Plan, I have determined that the level of reserves, contingencies and balances for the 2018/19 financial year are adequate'.* 'have *tried to keep a minimum of £15m in the General Fund Reserve'* but as at February 2018 was reporting a likely year end balance of £12.6m. As highlighted above the actual year-end balance is £20.9m but one again this is more a reflection of the inconsistency of reporting rather than any significant movement in the last few months of the year.

2018/19 Budget

At the same meeting the council set a net budget for 2018/19 of £316.9m. This included a net contribution from reserves of £2.6m. There was no reference to any proposed use of the capital flexibilities in the paper although mention of the council's ability to access funding through capital flexibilities is included within the efficiency plan for 2018/19, in line with the guidance. However other aspects of the directions have still not been complied with.

The LGA Peer review highlighted the '*need to tackle what we believe is a £17m turnaround position'* for 2018/19.

The overall budget is an increase from the 2017/18 position although the change in service line budgets varies. It is noted, that the budgets for adults and health and children and families services have decreased by £1.5m and £2.5m respectively when compared with the previous year. The 2018/19 budget has a number of assumptions built in covering areas such as council Tax increases and ongoing pressures. Ongoing pressures include £2.2m for pay awards and increased the cost of adult social care linked to the amount that can be raised through the Council Tax increase. The total of these pressures is £10.7m, which is included within service line budgets, and further impacts on deliverability. There is potential that the impact of the pressures allied to continued overspend in certain service areas will place further pressure on the council's reserves.

Our deep dive of the assumptions behind the 2018/19 budget raises concerns about the reasonableness of the children and families budget. Despite the overspend in 2017/18 the 2018/19 budget is below the original 2017/18 budget and is predicated on £2.6m of savings in this area.

The overall savings target for 2018/19 is set at £8.8m with a further £5.2m of prior year savings being brought forward. Therefore the total savings required in 2018/19 is £14.0m which allied with £10.7m of pressures requires the council to find a total of £24.7m in the 2018/19 budget. There is a significant inherent risk in the delivery of this budget that will require close monitoring from the outset.

At the time of drafting this report the month 2 position for 2018/19 indicated a projected overspend of £12.1m. Of this £20.2m related to children and families with underspends in other budget heads and centrally held contingencies reducing the figure council wide.

We have seen early signs of the financial challenges facing the council becoming the focus of priority across the council. SLT meetings now focus exclusively on this area and the CEO convened a meeting in June 2018 of all Strategic and Service Managers where he and the then S151 office went through the financial challenge, the background and what needs to happen to address the budget issues. This was supplemented with a note to staff in June explaining the financial challenge.

Management Response

Management's response to this is set out in the 'SCC Management Response To External Audit VFM Report' that is included on the agenda of the July 2018 Audit Committee.

Recommendations

We have made 7 of recommendations for the Council as a result of issues identified during the course of the value for money audit of Strategic Financial Planning as detailed in Appendix A.

Significant risk - Ofsted inspection of Children's Services

We reported in our audit plan that the Council's most recent inspection occurred in November 2017 prior to which the Council has been rated as inadequate and a direction notice issued. The Council is required to improve to exit directions and demonstrate the ability to manage services adequately. Failure to improve will result in further restrictions being applied and the possibility of the service being removed from the Council's control. Ofsted will report to the Council in January 2018.

We said that we would review progress made by the council in responding the findings from the latest Ofsted inspection including the outcomes from the latest inspection due in January 2018.

Overall Conclusion

Since the last formal inspection in 2015, when Somerset children's services were judged as '*inadequate'* overall, the council has made steady progress in improving the quality of services that children and young people receive. Senior leaders have worked effectively with an improvement partner, they have created a culture of openness and willingness to learn that supports further improvement. The full Ofsted inspection in November 2017 reported in January 2018 and judged the service as *'requires improvement to be good*'. Although further work is required to achieve a 'good' judgement, we consider that this improved rating demonstrates good progress in this area. We are, therefore, able to conclude that the council has proper arrangements for informed decision making to deliver strategic priorities in respect of children's services, except for the council wide issue referred to earlier for strategic financial planning.

Detailed Findings

The council were subject to an Ofsted inspection in November 2017 following on from previous inspections which had rated the Council as inadequate. The council has subsequently been working with an improvement partner, Essex County Council, to identify good practice and areas that require improvement in order to improve services and receive an improved rating.

An interim monitoring visit was undertaken by Ofsted in May 2017 and focused on how casework is progressed when it is transferred into the Children Looked After teams. The Ofsted inspectors assessed the quality of social work practice for children looked after.

As per the interim Ofsted letter the findings and evaluation of progress noted the following:

‘Based on the evidence gathered during the visit, inspectors identified areas of strength and areas where improvement is taking place. Overall, the pace of change, while adequate, now needs to accelerate. The key challenge for Somerset is to align and implement key inter-agency processes to create effective working practices in relation to Children who go missing and CSE procedures, to ensure that social work practice improvements in the children looked after service move beyond compliance and to maintain consistency across social work practice’

This is in line with our knowledge of the client and indicates that improvements were taking place. However, the report also indicated that there was still improvements required to move to ‘requires improvement’ from the previous rating of inadequate. The interim report also stated that:

‘Senior officers are highly aware of the wide range of tasks ahead of them to improve services for children. They have a clear and ongoing comprehensive programme of actions to raise standard. The local authority is energetic in its approach, yet is realistic about the improvements that are still required to raise outcomes for Children in Somerset’

This demonstrated that senior management were taking appropriate steps and knew what was required going forward to improve arrangements. There was regular reporting to cabinet on the actions required with the performance report to Cabinet in September 2017 indicating:

‘Ofsted quarterly monitoring visits have concluded adequate progress is being made and DfE intervention has confirmed a “significant improvement” in Somerset’s Children’s Services, including more manageable case-loads, a more stable worjforce and better partnership working as reported by the Minister in December 2016. Despite this, until a re-inspection services are judged inadequate and there is a corporate risk for Safeguarding Children that has a very high risk rating. Change is evident but universal improvement remains a challenge’

As noted in this assessment, there was a recognition that the council needed to improve and that the improvements made would need to be confirmed as part an overall inspection by Ofsted. The Ofsted inspection in November 2017 concluded that children’s services had improved and that the direction of travel from inadequate to require improvement was evidence of the processes that the council’s senior management have put in place to bring about changes to the service. With the exception of adoption which was rated good, performance in all areas were rated as requires improvement.

It is clear from the recommendations in the latest inspection report that there is still further work required and that the pace of change and improvement needs to be accelerated. Some of the recommendations, such as the foster homes availability may require further investment and expenditure at a time when the council’s finances are under extreme pressure and children’s services continue to overspend.

Independence and ethics

Independence and ethics

- We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Financial Reporting Council's Ethical Standard and confirm that we, as a firm, and each covered person, are independent and are able to express an objective opinion on the financial statements

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in December 2017 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

Details of fees charged are detailed in Appendix D

Audit and Non-audit services

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The following non-audit services were identified.

Service	£	Threats	Safeguards
Non-audit related			
Certification of Teacher's Pension Return	4,200	Self-Interest	This is a recurring fee and therefore a self interest threat exits. 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 of the County Council and in particular to Grant Thornton UK LLP's 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.
Certification of School centred Initial Teacher Training	3,750	Self-interest	This is a recurring fee and therefore a self interest threat exits. 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 of the County Council and in particular to Grant Thornton UK LLP's 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.

The amounts detailed are fees agreed to-date for audit related and non-audit services to be undertaken by Grant Thornton UK LLP in the current financial year. These services are consistent with the Council's policy on the allotment of non-audit work to your auditors. Any changes and full details of all fees charged for audit related and non-audit related services by Grant Thornton UK LLP and by Grant Thornton International Limited network member Firms will be included in our Audit Findings report at the conclusion of the audit.

Action plan

We have made 7 recommendations to the Council as a result of issues identified during the course of our value for money audit. We have agreed our recommendations with management and we will report on progress on these recommendations during the course of the 2018/19 audit. We have also made one recommendation in respect of our opinion audit. The matters reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with auditing standards.

Assessment	Recommendations - VFM	Management Response
R ●	1. The council should review the format of its budget setting, monitoring and outturn reports to ensure they maximise the ability of both officers and members to understand and challenge delivery against budget. As part of this process, members should be consulted with to determine what they would like to see and, in particular, how risks to non-delivery will be flagged.	Please see the 'Initial Actions – subject to further review and action planning' section of the 'SCC Management Response To External Audit VFM Report' that is included on the agenda of the July 2018 Audit Committee.
R ●	2. The council should consider what is a realistic and achievable base budget for each service area, having regard to the previous year's performance. As part of this process, consideration should be given, to what level of contingency, if any, should be set aside for unexpected pressures versus direct service line allocation.	Please see the 'Initial Actions – subject to further review and action planning' section of the 'SCC Management Response To External Audit VFM Report' that is included on the agenda of the July 2018 Audit Committee.
R ●	3. The council should ensure that there is consistency of reporting between budget setting and monitoring with a clear approach to how savings are identified, quantified financially and monitored. If annual savings are to be identified on a thematic basis, they should also be monitored on a thematic basis. Where savings are built into service line budgets, a full reconciliation should be provided to show how these impact on thematic savings targets	Please see the 'Initial Actions – subject to further review and action planning' section of the 'SCC Management Response To External Audit VFM Report' that is included on the agenda of the July 2018 Audit Committee.
R ●	4. Committees and meetings responsible for monitoring financial delivery should explicitly minute the challenge and actions taken, where necessary, in response to in year overspends. These should be followed-up at the next meeting to ensure the proposed action is having the desired effect and to inform what further action, if any, is needed.	Please see the 'Initial Actions – subject to further review and action planning' section of the 'SCC Management Response To External Audit VFM Report' that is included on the agenda of the July 2018 Audit Committee.
A ●	5. Reporting of financial performance to members should be transparent and understandable and include greater analysis of areas such as use of reserves or grants and application and achievement of transformational projects through the use of capital flexibilities.	Please see the 'Initial Actions – subject to further review and action planning' section of the 'SCC Management Response To External Audit VFM Report' that is included on the agenda of the July 2018 Audit Committee.

Controls
- ● High – Significant effect on control system
- ● Medium – Effect on control system
- ● Low – Best practice

Action plan (continued)

Assessment	Recommendation - VFM	Management Response
A●	6. Capital flexibilities should be reported and monitored in line with Central Government guidelines. All identified projects should be included in the budget process and approved prior to the financial year along with achievement against prior year projects. In-year reporting should update for any changes including newly identified projects or those projects that are delayed or unlikely to deliver	Please see the 'Initial Actions – subject to further review and action planning' section of the 'SCC Management Response To External Audit VFM Report' that is included on the agenda of the July 2018 Audit Committee.
R●	7. The S151 officer in his/her annual reporting under Section 25 of the LG Act 2003 on the adequacy of reserves should clearly articulate their view on the adequacy of both general fund and other reserves (including earmarked reserves) along with any proposed actions to strengthen these going forward. As part of this process, consideration should be given, to the appropriateness of holding negative earmarked reserves.	Please see the 'Initial Actions – subject to further review and action planning' section of the 'SCC Management Response To External Audit VFM Report' that is included on the agenda of the July 2018 Audit Committee.

Controls
- ● High – Significant effect on control system
- ● Medium – Effect on control system
- ● Low – Best practice

Action plan (continued)

Assessment	Recommendations - Opinion	Management Response
A●	8. To reduce the risk of material error from journal adjustments made in the general ledger, the Council should include, in its journal policy, the requirement that all journals should be authorised by a second person	Somerset CC (SCC) finance officers do not share the view of the external auditors on the need to have journals authorised by a second person:- From a fraud perspective, there are controls already in place in the AP and AR systems, including segregation of duties around key tasks. This is where the real risks lie. Journals do not actually involve expenditure or income, so the inherent risk to SCC is absolutely minimal. Regular internal audit work on our AP and AR systems have not demonstrated any risks that would need an additional authorisation to journals in the general ledger. This work provides on-going evidence of the strength of controls in those systems fundamental to the Council's internal control framework. Each user of SAP has an individual ID that is registered against each transaction that the user makes. Any unusual suspicious journals are going to be traceable to a single member of staff. There are restrictions around the number of SAP users who can actually carry our journals – it is not as if this is standard functionality available to all users, but is restricted to key finance staff only. (These are very rarely AR and AP users). Key journals have other controls – in particular accruals over £25k do actually need to be signed off by a Strategic Manager before being processed. SCC's budget monitoring acts as another control in order to pick up rogue journals. Budget management / service budget holders would be surprised to see any transactions on their codes that they did not recognise and would investigate. No examples have been offered by either Grant Thornton or SWAP of journals where this has occurred – either fraudulently or by error. SCC has provided a full journal list to Grant Thornton for SCC . SCC has to consider the costs of control, which are potentially high. These may include – (i) the possible need to reconfigure SAP and to pay to do so, requiring journals to be authorised; (ii) the costs of maintaining GL authorisation lists in addition to AP / AR authorisation lists; and (iii) the costs of having additional finance staff involved in the process, both in terms of adding staff and in terms of slowing down bona fide accounting transactions.

Controls
- ● High – Significant effect on control system
- ● Medium – Effect on control system
- ● Low – Best practice

Follow up of prior year recommendations

We identified the following issue in the audit of Somerset County Council's 2016/17 financial statements, which resulted in 1 recommendation being reported in our 2016/17 Audit Findings report. We have followed up on the implementation of our recommendation and note that is still to be completed.

	Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
1	X	• To reduce the risk of material error from journal adjustments made in the general ledger, we recommend that Somerset County Council includes, in its journal policy, the requirement that all journals should be authorized by a second person.	• As in prior years finance officers believe there is sufficient controls in place to mitigate the risk and have therefore declined to amend the process. This risk and recommendation will be included in the 2017-18 Audit Findings Report. Please see previous page for detail.

Assessment
✓ Action completed
X Not yet addressed

Audit Adjustments

We are required to report all non trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management.

Impact of adjusted misstatements

There are no adjusted misstatements in 2017/18

Impact of unadjusted misstatements

There are no unadjusted misstatements in 2017/18

Audit Adjustments

Misclassification and disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

Disclosure omission	Detail	Auditor recommendations	Adjusted?
Critical judgements	• Reference to 'futures for Somerset' indicates that there should be group accounts which is contradicted by further disclosures	• The Council should expand the consideration of 'Futures for Somerset' and included further narrative within the critical judgements to allow the reader to understand the relationship between the two organisations	✓
Contingent Liabilities	• The Council as providers of social services are subject to the current legal consideration for the pay of workers who stay overnight. There is a potential liability to the Council for this ruling	• The Council should include a disclosure showing the consideration of the potential liability that may accrue as a result of any legal ruling.	✓
Capital Grants (note 40)	• A grant received in advance has been incorrectly classified	• A grant of £1.782m has been incorrectly classified as a Department for Transport grant received in advance and should be a Standards Fund grant received in advance. The Council should adjust the disclosure to ensure that figures are accurately reported. There is no effect on the financial statements	✓
General Disclosures	• Other general amendments	• Other amendments including spelling, grammar and syntax and other minor disclosures which have not been separately disclosed should be adjusted and included.	✓

Fees

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

Audit Fees

	Proposed fee	Final fee
Council Audit	£99,873	TBC*
Total audit fees (excluding VAT)	**£99,873**	**TBC***

***Fee variation**
The proposed fees for the year will be in excess of the scale fee set by Public Sector Audit Appointments Ltd (PSAA) of £99,873. The additional fee is yet to be finalised and is in respect of our expanded work under Strategic Financial Planning based on our updated assessment of risk. Once the additional fee has been calculated, following the completion of the audit, it wlll be communicated to officers and subsequently to the Audit Committee as Those Charged with Governance. This additional fee has yet to be agreed and will be subject to approval from PSAA via the fee variations process.

Fees in respect of grant work, such as reasonable assurance reports, are shown under 'Fees for other services'.

Non Audit Fees

Fees for other services	Fees £
Non-audit services	
• Teacher’s Pension Certification	4,200
• SCITT	3,750
	7,950

Draft Audit opinion

Independent auditor's report to the members of Somerset County Council

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Somerset County Council (the 'Authority') for the year ended 31 March 2018 which comprise the Comprehensive Income and Expenditure Statement, Movement in Reserves Statement, the Balance Sheet, the Cash Flow Statement, and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2017/18.

In our opinion the financial statements:

- give a true and fair view of the financial position of the Authority as at 31 March 2018 and of its expenditure and income for the year then ended;
- have been prepared properly in accordance with the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2017/18; and
- have been prepared in accordance with the requirements of the Local Audit and Accountability Act 2014.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Authority in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Who we are reporting to

This report is made solely to the members of the Authority, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014 and as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. Our audit work has been undertaken so that we might state to the Authority's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's members as a body, for our audit work, for this report, or for the opinions we have formed.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Chief Finance Officer's use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Chief Finance Officer has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Authority's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Other information

The Chief Finance Officer is responsible for the other information. The other information comprises the information included in the Statement of Accounts set out on pages 1 to 11 and 17 to 40, the Narrative Report from the Chief Finance Officer, Statement of Responsibilities and the Annual Governance Statement, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge of the Authority obtained in the course of our work including that gained through work in relation to the Authority's arrangements for securing value for money through economy, efficiency and effectiveness in the use of its resources or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Other information we are required to report on by exception under the Code of Audit Practice

Under the Code of Audit Practice published by the National Audit Office on behalf of the Comptroller and Auditor General (the Code of Audit Practice) we are required to consider whether the Annual Governance Statement does not comply with the 'Delivering Good Governance in Local Government: Framework (2016)' published by CIPFA and SOLACE or is misleading or inconsistent with the information of which we are aware from our audit. We are not required to consider whether the Annual Governance Statement addresses all risks and controls or that risks are satisfactorily addressed by internal controls.

We have nothing to report in this regard.

Draft Audit opinion

Opinion on other matter required by the Code of Audit Practice

In our opinion, based on the work undertaken in the course of the audit of the financial statements and our knowledge of the Authority gained through our work in relation to the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources, the other information published together with the financial statements in the Statement of Accounts, the Narrative Report from the Chief Finance Officer and the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

Under the Code of Audit Practice we are required to report to you if:

- we have reported a matter in the public interest under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or
- we have made a written recommendation to the Authority under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or
- we have exercised any other special powers of the auditor under the Local Audit and Accountability Act 2014.

We have nothing to report in respect of the above matters.

Responsibilities of the Authority, the Chief Finance Officer and Those Charged with Governance for the financial statements

As explained more fully in the Statement of Responsibilities set out on page 11, the Authority is required to make arrangements for the proper administration of its financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In this authority, that officer is the Chief Finance Officer. The Chief Finance Officer is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2017/18, which give a true and fair view, and for such internal control as the Chief Finance Officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Chief Finance Officer is responsible for assessing the Authority's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Authority lacks funding for its continued existence or when policy decisions have been made that affect the services provided by the Authority.

The Audit Committee is Those Charged with Governance.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Report on other legal and regulatory requirements - Conclusion on the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources

Qualified Adverse Conclusion

On the basis of our work, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General in November 2017, because of the significance of the matters described in the basis for adverse conclusion section of our report, we are not satisfied that, in all significant respects Somerset County Council have put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018

Basis for qualified adverse Conclusion

The Authority's financial health has deteriorated over the last 12 months due to continued overspending, predominantly in the area of children and families. This has necessitated further use of already depleted reserves that now means the council has limited capacity to fund any further overspending. The inability of the Authority to deliver against its budget is now pervasive to the whole Authority and without urgent actions could result in it running out of money in the next two to three years. Further effort is now required to ensure budgets are delivered and the Authority repositions itself on a sustainable financial footing. To facilitate this, arrangements for budget setting, internal budget monitoring and internal financial reporting need improving to ensure consistency of reports that contain the appropriate level of detail to ensure challenge takes place and decisions are taken based on complete and accurate information.

Draft Audit opinion

This matter is evidence of weaknesses in proper arrangements for sustainable resource deployment in planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions.

In light of this conclusion above, we are unable to state that Somerset County Council has proper arrangements in place to ensure sustainable resource deployment because we believe this has now become pervasive to the effective functioning of the whole council. As a result, we propose to issue an adverse 2017/18 value for money conclusion.

Responsibilities of the Authority

The Authority is responsible for putting in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

Auditor's responsibilities for the review of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources

We are required 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. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

We have undertaken our review in accordance with the Code of Audit Practice, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General in November 2017, as to whether in all significant respects the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. The Comptroller and Auditor General determined this criterion as that necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to be satisfied that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

Report on other legal and regulatory requirements - Delay in certification of completion of the audit

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 2018. 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 2018. 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 2018.

Signature – To be added

Peter Barber
for and on behalf of Grant Thornton UK LLP, Appointed Auditor

2 Glass Wharf
Bristol
BS2 0EL

Date – To be added

Grant Thornton

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