Annual Audit Letter

Year ending 31 March 2018

Somerset County Council and Pension Fund

August 2018

Contents

Your key Grant Thornton team members are:

Peter Barber

Engagement lead

T: 0117 305 7897

E: peter.a.barber@uk.gt.com

David Johnson

Engagement Manager

T: 0117 305 7727

E: david.a.Johnson@uk.gt.com

Aditi Chandramouli

In Charge Accountant – Somerset County Council

T: 0117 305 7643

E: aditi.Chandramouli@uk.gt.com

Steph Thayer

In Charge Accountant – Somerset Pension Fund

T: 0117 305 7821

E: steph.e.Thayer@uk.gt.com

Executive Summary

Purpose

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

This Letter is intended to provide a commentary on the results of our work to the Council and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Council's Audit Committee as those charged with governance in our Audit Findings Reports on 26 July 2018.

Respective responsibilities

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

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

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

Our work

Materiality	We determined materiality for the audit of the Council's financial statements to be £15.1 million, which is 1.8% of the Council's gross revenue expenditure. We determined materiality for the audit of the pension fund accounts administered by the Council to be £19.7 million, which is 1% of the pension fund's net assets.
Financial Statements opinion	We gave an unqualified opinion on the Council's financial statements on 30 July 2018. We gave an unqualified opinion on the pension fund accounts of Somerset Pension Fund on 30 July 2018.
Whole of Government Accounts (WGA)	We completed work on the Council's consolidation return following guidance issued by the NAO. We issued an assurance statement on 29 July 2018.
Value for Money arrangements	We were not satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources because of weaknesses in financial management including budget monitoring, reporting and management of overspends and sufficiently robust challenge by members and officers. We therefore issued an adverse value for money conclusion in our audit report to the Council on 30 July 2018.

Executive Summary

Use of statutory powers	We did not identify any matters which required us to exercise our additional statutory powers. Our work on the Council's arrangements for securing sustainable resource deployment (part of the Value for Money arrangements) included a number of recommendations to improve arrangements. At the reporting stage, we decided not to exercise these powers, but indicated we would 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 in this area not improve and/or further significant overspends emerge during the course of 2018/19.
Certificate	We are currently unable to certify that we have completed the audit of the accounts of Somerset County Council for 2017/18 as we have not yet given an audit opinion on the pension fund annual report.

Working with the Council

- An efficient audit – we delivered an efficient audit with you, delivering the accounts by the 31 July deadline, releasing your finance team for other work.
- Sharing our insight – we provided regular audit committee updates covering best practice. We also shared our thought leadership reports.
- Providing training – we provide your teams with training on financial accounts and annual reporting on a regular basis.

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

Grant Thornton UK LLP
August 2018

Audit of the Accounts

Our audit approach

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

We determined materiality for the audit of the Council's accounts to be £15.1 million, which is 1.8% of the Council's gross revenue expenditure. We used this benchmark as, in our view, users of the Council's financial statements are most interested in where the Council has spent its revenue in the year.

We also set a lower level of specific materiality for senior officer remuneration and related party transactions of £5,000 due to the sensitive nature of these balances.

We set a lower threshold of £755,000, above which we reported errors to the Audit Committee in our Audit Findings Report.

Pension Fund Materiality
For the audit of the Somerset Pension Fund accounts, we determined materiality to be £19.7 million, which is 1% of the Fund's net assets. We used this benchmark, as in our view, users of the Pension Fund accounts are most interested in the value of assets available to fund pension benefits.

We set a lower level of specific materiality for certain areas such as management expenses. We set a threshold of £500,000 above which we reported errors to the Audit Committee in our Pension Fund Audit Findings Report.

The scope of our audit
Our audit involves obtaining sufficient evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error. This includes assessing whether:
- the accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the Statement of Accounts, the narrative report and the annual governance statement to check they are consistent with our understanding of the Council and with the financial statements included in the Statement of Accounts on which we gave our opinion.

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

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

We identified key risks for the Council and Pension Fund and set out on the following pages the work we performed in response to these risks and the results of this work.

Audit of the Accounts

Council Significant Audit Risks

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
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	As part of our audit work we have: • 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 for journals.
Improper revenue recognition Under ISA (UK) 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.	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 for non-fees and charges income streams, 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	Our audit work has not identified any issues in respect of revenue recognition.

Audit of the Accounts

Council Significant Audit Risks

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
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	As part of our audit work we have: • 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	As part of our audit work we have: • 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.

Audit of the Accounts

Pension Fund Significant Audit Risks

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
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. We identified management override of controls as a risk requiring special audit consideration.	As part of our audit work we have: We have undertaken the following work in relation to this risk • Gained an understanding of the accounting estimates, judgements applied and decisions made by management and considered their reasonableness • Obtained a full listing of journal entries, identified and tested unusual journal entries for appropriateness • Evaluated the rationale for any changes in accounting policies or significant unusual transactions	Our audit work has not identified any issues in respect of management override of controls with the exception of the Pension Fund policy for journals not requiring a second authoriser.
Improper revenue recognition Under ISA 240 (UK) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.	Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Pension Fund, 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 Pension Fund, mean that all forms of fraud are seen as unacceptable Therefore we do not consider this to be a significant risk for Somerset Pension Fund.	Our audit work has not identified any issues in respect of revenue recognition.

Audit of the Accounts

Pension Fund Significant Audit Risks

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
The valuation of Level 3 investments is incorrect Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end. We identified the valuation of level 3 investments as a risk requiring special audit consideration. .	As part of our audit work we completed; • gained an understanding of the Fund's process for valuing level 3 investments and evaluate the design of the associated controls • Reviewed the nature and basis of estimated values and considered what assurance management has over the year end valuations provided for these types of investments • Considered the competence, expertise and objectivity of any management experts used • Reviewed the qualifications of the expert to value Level 3 investments at year end and gained an understanding of how the valuation of these investments has been reached • For a sample of investments, tested the valuation by obtaining and reviewing the audited accounts, (where available) at the latest date for individual investments and agreed these to the fund manager reports at that date. Reconciled those values to the values at 31 March 2018 with reference to known movements in the intervening period	Our audit work has not identified any issues in respect of level 3 investments

Audit of the Accounts

Audit opinion
We gave an unqualified opinion on the Council's financial statements on 30 July 2018, in advance of the earlier national deadline.

Preparation of the accounts
The Council presented us with draft accounts in accordance with the national deadline of 31 May 2018 and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit.

Issues arising from the audit of the accounts
We reported the key issues from our audits to the Council's Audit Committee on 26 July 2018.

Annual Governance Statement and Narrative Report
We are required to review the Council’s Annual Governance Statement and Narrative Report. It published them on its website in the Statement of Accounts in line with the national deadlines.

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

Whole of Government Accounts (WGA)
We carried out work on the Council’s Data Collection Tool in line with instructions provided by the NAO. We issued an assurance statement on 29 August 2018 which identified that the Council are unable to identify the split of the pension costs between funded and unfunded as the Actuary has not been commissioned to undertake this work. Assurance is taken from agreement of the overall figure and the movement in the year and this issue will be reported to the NAO.

No other items have been identified that require reporting to the NAO.

Pension fund accounts
We gave an unqualified opinion on the pension fund accounts of Somerset Pension Fund on 30 July 2018, in advance of the earlier national deadline.

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

Certificate of closure of the audit
We are currently unable to certify that we have completed the audit of the accounts of Somerset County Council for 2017/18 as we have not yet given an audit opinion on the pension fund annual report.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 which specified the criterion for auditors to evaluate:
In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Key findings

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

The key risks we identified and the work we performed are set out on the following pages.

Overall Value for Money conclusion

We were not satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources because of weaknesses in financial management including budget monitoring, reporting and management of overspends and sufficiently robust challenge by members and officers . We therefore issued an adverse value for money conclusion in our audit report to the Council on 30 July 2018.

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.

Recommendations for improvement

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

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

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.

Value for Money conclusion

Key Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Financial sustainability 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 have reviewed the project management and assurance frameworks established by the Council to understand how it is identifying, managing and monitoring these financial risks. We have reviewed 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 has looked at the delivery of the 2017/18 budget, including savings targets, as well as considering the robustness of the MTFP	In 2016/17 we highlighted that the Council's combined level of general fund reserves and other earmarked reserves had fallen significantly over the recent years and that this was clearly not sustainable. Over the last 12 months the Council's financial position has increasingly come under the spotlight including the LGA 'Corporate Peer Challenge' feedback report and reports from Internal Audit. **Budget Setting:** At 31 March 2017 the audited accounts reported a General Fund balance of £20.2m and earmarked reserves of £8.1m. This fed into consideration of the 2017/18 budget which 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 2017/18 net budget of £311.8m represented a small reduction from the 2016/17 budget and included, for the demand led areas, a reduction in children's services and an increase in adults and health services. The budget was predicated on the delivery of £18.1m of in year savings, subsequently increased to £19.5m when previous year savings slippage was added. The budget included an unallocated contingency of £10.1m that was used to finance possible pressures arising in the year. Our experience suggests that 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 projecting an overspend of £8.7m. The report introduces the use of earmarked reserves and grants to reduce projected overspends. In our opinion the ability to gain a clear understanding of the financial position has been further compounded by the 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. Our review identified that although a large number of smaller savings schemes were delivered overall achievement of the savings target in year was adversely impacted by the failed delivery of the high value schemes. For three programmes with a total savings target of £13.5m only £5.6m was realised in year. As a result only £11.1m (57%) of the budgeted £19.5m savings were delivered in 2017/18. No year end outturn position has been reported against the original thematic basis and therefore it is not possible to identify which of the thematic savings approached has been a success. Early on in 2017/18 the pressure on the children and families budget emerged with an overspend of £14.5m forecast at month 2. We did not see any evidence as to what action was agreed or

Value for Money conclusion (continued)

Key Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Financial sustainability 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 have reviewed the project management and assurance frameworks established by the Council to understand how it is identifying, managing and monitoring these financial risks. We have reviewed 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 has looked at the delivery of the 2017/18 budget, including savings targets, as well as considering the robustness of the MTFP	taken to bring the service back in line. Although not present at SLT or cabinet our review of minutes of both indicates limited evidence of agreed actions to address the emerging overspends. In 2016/17 the Government introduced a new capital flexibilities facility. The Council used this flexibility to finance £4m of expenditure in 2017/18. The Council has, in our opinion, complied with the spirit of the requirements 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. **2017/18 Outturn:** The 2017/18 outturn reported a £2.2m overspend. This was achieved after a number of revisions to the original budget and in year use of reserves. In order to assess the underlying position the outturn needs to be compared with the original budget and prior to use of unplanned reserves. At Somerset reserves appear to have been used in an unplanned way to reduce overspend as demonstrated by the £4.9m used in the Learning Disabilities equalisation reserves despite there being no opening balance. The overspend in the budget has been well publicises due to overspend in children's and families which was reported as £9.7m in the outturn report. Once the use of reserves is added back the overspend is closer to £12m. The requirement to move children's services from Inadequate to Requires Improvement under the Ofsted regime has led to the overspend in prior years. However 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 forwards further overspends will arise leading to the need to utilise more of the depleted reserves or cut services elsewhere **Balance and reserves**: The net impact of the overspend in 2017/18 is to reduce the total level of reserves. We have reviewed General fund and Earmarked reserves together to form an opinion on the adequacy of these reserves. As at 31 March 2015 general fund and earmarked reserves totalled £80.4m and at 31 March 2018 were £23.7m, a reduction of 71%. Of the 27 County Councils in England Somerset has lower levels of earmarked reserves than any other county council and is therefore heavily reliant on its general fund to cover any unplanned savings.

Value for Money conclusion (continued)

Key Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Financial sustainability 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 have reviewed the project management and assurance frameworks established by the Council to understand how it is identifying, managing and monitoring these financial risks. We have reviewed 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 has looked at the delivery of the 2017/18 budget, including savings targets, as well as considering the robustness of the MTFP	**2018/19 Budget:** The Council has set a budget of £316.9m for 2018/19. There was no reference to any proposed use of capital flexibilities although mention of the Council's ability to access this is included within the efficiency plan for 2018/19. The overall budget is an increase from the 2017/18 position although the budget for children's and families and for adult services have both decreased. Total pressures of £10.7m have been included which 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. The overall savings target for 2018/19 is set at £8.8m with a further £5.2m of prior year savings being brought forward. The month 2 position for 2018/19 indicated a projected overspend of £12.1m which is a net position. The overspend in Children's services is £20.2m at month 2. **Conclusion:** The Council's financial health has deteriorated over the last 12 month due to continued overspending. This has necessitated further use of already depleted reserves that now means the Council has limited capacity to fund any further overspend. The inability of the Council to deliver against its budget is 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 the conclusion above, we were 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 issued an adverse 2017/18 value for money conclusion.

Value for Money conclusion (continued)

Key Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Ofsted inspection of Children's Services 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 have reviewed progress made by the council in responding the findings from the latest Ofsted inspection.	The council has 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. Our review of follow up visits by Ofsted 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.

A. Reports issued and fees

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

Reports issued

Report	Date issued
Audit Plan	January 2018
Audit Findings Report	July 2018
Annual Audit Letter	August 2018

Fees

	Planned £	Actual fees £	2016/17 fees £
Statutory Council audit	99,873	111,209*	99,873
Audit of Pension fund	23,859	23,859	23,859
Total fees	**123,732**	**135,068**	**123,732**

***Fee variation**
The proposed statutory Council audit fees for the year is £11,336 more than the scale fee set by Public Sector Audit Appointments Ltd (PSAA) of £99,873. The additional fee is in respect of our expanded work under Strategic Financial Planning based on our updated assessment of risk. This additional fee is subject to approval by Public Sector Audit Appointments Ltd via the fee variations process.

Fees for non-audit services

Service	Fees £
Audit related services	
- Teachers Pension £4.200	TBC
- SCITT £3,750	TBC

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 table above summarises all non-audit services which were identified.
- We have considered whether non-audit services might be perceived as a threat to our independence as the Council's auditor and have ensured that appropriate safeguards are put in place.

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

B: Action plan

We have identified 7 of recommendations for 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. 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	Recommendation	Management Response
●	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.
●	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.
●	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.
●	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.

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

B: Action plan (continued)

We have identified 7 of recommendations for 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. 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	Recommendation	Management Response
●	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.
●	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.
●	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

B: Action plan (continued)

We have identified 1 recommendation for the Council as a result of issues identified during the course 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	Recommendation	Management Response
● (Medium)	8. The current journal policy does not require a second person to authorize journals before they are posted to the general ledger. There is a risk of self authorization that could lead to fraudulent journals being posted To reduce the risk of material error from journal adjustments made in the general ledger, we recommend that Somerset Pension Fund includes, in its journal policy, the requirement that all journals should be authorized 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

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