The Audit Findings for Somerset County Council

Year ended 31 March 2019

22 July 2019

Contents

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The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose all defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

Headlines

This table summarises the key findings and other matters 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 2019 for those charged with governance.

Financial Statements	Under International Standards of Audit (UK) (ISAs) and the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report whether, in our opinion, the Council's financial statements: • give a true and fair view of the financial position of the Council and Council's income and expenditure 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 Annual Governance Statement (AGS), Narrative Report and Pension Fund Financial Statements), 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 in late May and as at 22 July 2019 our audit is substantially complete. Our findings are summarised on pages 5 to 13. We have identified no material errors or adjustments to the financial statements. Following the receipt of the draft accounts the Council sought from its actuary an assessment of the impact of the McCloud legal ruling. This identified a £13.2 million increase in the actuarial present value of promised retirement benefits that has been adjusted for in the Council's Comprehensive Income and Expenditure Statement and Balance Sheet. We have also recommended a number of other adjustments to improve the presentation of the financial statements. Our review of the PPE valuation identified a £9.0 million error resulting from, what in our view is, an inappropriate downward revaluation of a group of schools land by a blanket 24%. The Council has decided not to adjust for this and we are satisfied that this is not material to the overall financial statements. Audit adjustments are detailed in Appendix C. We have also raised recommendations for management as a result of our audit work in Appendix A. Our follow up of recommendations from the prior year's audit are detailed in Appendix B. We have concluded that the other information to be published with the financial statements is consistent with our knowledge of your organisation and the financial statements we have audited. Our audit work continues and we will provide a further update on progress at the Audit Committee. Subject to a number of outstanding queries being resolved, we anticipate issuing an unqualified audit opinion following the Audit Committee meeting on 30 July 2019, as detailed in Appendix E.
Value for Money arrangements	Under the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report if, 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').	In order to arrive at the appropriate VFM conclusion for 2018/19 we are now seeking more assurances over the embeddedness of the arrangements in respect of sustainable resource deployment. This will necessitate further work around the robustness of the Council's MTFP and in particular the deliverability of the Children Services and Adults Services budgets through to 2021/22. As a result of this proposed additional work we are unable to conclude our VFM conclusion by 31 July 2019. Our auditors expert are aiming to complete this work by the end of August 2019 and we proposed to use their findings to inform our final VFM conclusion for 2018/19 that will be reported to the Audit Committee at their September 2019 meeting.
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 • To 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 but are unable to issue our completion certificate due to the following: • Outstanding VFM work in respect of demand lead budgets yet to be concluded (work due to complete by the 31 August 2019) • Whole of Government Accounts statement (deadline 31 August 2019) • Opinion on the consistency of the pension fund financial statements with the Pension Fund Annual Report (deadline 1 December 2019)

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 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 and will and will be presented to the Audit Committee.

As auditor we are responsible for performing the audit, in accordance with International Standards on Auditing (UK) and the Code, 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;
- Substantive testing on significant transactions and material account balances, including the procedures outlined in this report in relation to the key audit risks

We have not had to alter or change our audit plan, as communicated to you on 31 January 2019.

Conclusion

Our audit work continues, which is primarily internal and we will provide a further update on progress at the Audit Committee. Our focus over the next week is in the following areas:

- Review of the updated actuary report for the McCloud ruling regarding age discrimination including reviewing the adjustments to pension figures within the accounts;
- Completion of final considerations of PPE valuations;
- Review of financial instruments disclosures;
- Receipt of the pension fund auditor's IAS19 letter of assurance;
- Review of provisions assumptions;
- Revie of contingent liabilities;
- Completion of testing around unrecorded liabilities and journals;
- Various other disclosure notes;
- Consideration of final peer and technical team response to queries, and
- Review of the final set of financial statements.

Subject to outstanding queries being resolved, we anticipate issuing an unqualified audit opinion following the Audit Committee meeting on 30 July 2019, as detailed in Appendix E

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 remain the same as reported in our audit plan

	Council Amount (£)	Qualitative factors considered
Materiality for the financial statements	14,300,000	Materiality has been based on 1.75% of the Authority's gross expenditure
Performance materiality	10,725,000	Our performance materiality has been set at 75% of our overall materiality
Trivial matters	713,000	This is set at 5% of financial statements materiality and reflects a level below which stakeholders are unlikely to be concerned by uncertainties.
Materiality for Senior Officer Remuneration	20,000	The senior officer remuneration disclosure in the statement of accounts has been identified as an area requiring lower materiality due to its sensitive nature. Materiality has been set for this at £20,000

Significant findings – audit risks

Risks identified in our Audit Plan	Commentary
The revenue cycle includes fraudulent transactions Under ISA (UK) 240 there is a rebuttable 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** As per the audit plan this risk has been rebutted. Having considered the risk factors set out in ISA240 and the nature of the revenue streams at Somerset County Council, we have determined that the risk of fraud arising from revenue recognition can be rebutted, in summary because: • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited • the culture and ethical frameworks of Local Government authorities, including Somerset County Council means that all forms of fraud are difficult to rationalise i.e. the culture and ethics mitigate against fraud being seen as acceptable 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. Management over-ride of controls is a risk requiring special audit consideration. We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk, which was one of the most significant assessed risks of material misstatement.	**Auditor commentary** We have performed the following work in respect of this risk: • evaluated the design effectiveness of management controls over journals • analysed the journals listing and determine the criteria for selecting high risk unusual journals • tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration • gained an understanding of the accounting estimates and critical judgements applied by management and considered their reasonableness with regard to corroborative evidence • evaluated the rationale for any changes in accounting policies, estimates and significant unusual transactions • Reviewed assurances from Those Charged with Governance and management in relation to fraud, law and regulations **Our audit work has not identified any issues in respect of management override of controls.**

Significant findings – 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 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 revaluations and impairments as a risk requiring special audit consideration.	**Auditor commentary** We have: • evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work • evaluated the competence, capabilities and objectivity of the valuation expert • discussed with the valuer to confirm the basis on which the valuation was carried out • challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding • tested revaluations made during the year to see if they had been 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 has satisfied themselves that these are not materially different to current value at year end. **Findings** Our audit work identified one issue into the downward revaluation of schools land not subject to a formal valuation in year. More detail is provided on page 8. Based on our own application of relevant indices to the population, we are satisfied that this does not give rise to a material difference based on our different estimation techniques. Our audit work has not identified any other issues in respect of the valuation of property, plant and equipment.

Significant findings – audit risks

Risks identified in our Audit Plan	Commentary
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: • updated our understanding of the processes and controls put in place by management to ensure that the Authority's pension fund net liability is not materially misstated and evaluate the design of the associated controls; • evaluated the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work; • assessed the competence, capabilities and objectivity of the actuary who carried out the Authority's pension fund valuation; • assessed the accuracy and completeness of the information provided by the Authority to the actuary to estimate the liability; • tested the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary; • undertaken procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report; and • obtained assurances from the auditor of Somerset Pension Fund as to the controls surrounding the validity and accuracy of membership data; contributions data and benefits data sent to the actuary by the pension fund and the fund assets valuation in the pension fund financial statements. Our audit work has not identified any issues in respect of the Pension Fund net liability, except for the impact of the McCloud judgement resulting in adjustments to the Council's IAS 19 pension liability. More information on this adjustment is provided on page 10. This adjustment totalling £13.168 million has been made to the final version of the financial statements. We are currently working through this adjustment to gain assurance that the basis is reasonable. We will provide an update on this to Audit Committee members at the meeting on 30 July 2019.

Significant findings – key judgements and estimates

	Summary of management's policy	Audit Comments	Assessment
Land and Buildings - £445m	Other land and buildings comprises £445m of specialised assets such as schools and libraries which are required to be valued at depreciated replacement cost (DRC), reflecting the cost of a modern equivalent asset necessary to deliver the same service provision. The remainder of other land and buildings are not specialised in nature and are required to be valued at existing use in value (EUV) at year end. The Council engages it's inhouse valuer to undertake the annual valuations who utilises the support of external valuers where required. The Council's land and buildings are revalued on a five year cycle. In 2018/19 the Council valued a significant proportion of all land and building assets as at 1 September 2018.	• As set out in Note 22, 76% of the Council's Land and Buildings totalling £337 million was valued in 2018/19. Given the valuation date for these assets was 1 September 2018 we have assessed the reasonableness of the valuers declaration that there has been no material movement in carrying value between the valuation date and the balance sheet date. Based on our own application of relevant indices indicating possible movements we are satisfied that there are no material movements for the last 7 months of the year. • For the residual Land and Buildings not revalued in 2018/19 totalling £108 million we have evaluated the assumptions made by management and how they has satisfied themselves that these are not materially different to current value. Although we have gained sufficient assurance from our work using our own indices in this area we note that a 24% downward revaluation has been applied to all school land assets not subject to a formal revaluation in the year. • This has not been based on a formal revaluation by the valuer but on the average reduction of those subject to valuation in the year. In our opinion, this is not appropriate basis for revaluing these assets as the reduction does not consider the specific factors of each asset individually in arriving at the appropriate carrying value. • Our estimation of movements in your asset base against your estimation is set out in the following table.	Amber

	NBV in Draft financial statements	Current value based on indicies	Variance
Buildings - Valued in 2018-19	253090980	259759259	-1274745
Land - Valued in 2018-19	83663080	82980116	-682964
Buildings - Not valued in 2018-19	55505969	56634664	1128695
Land - Not Valued in 2018-19	52717020	52669009	-48011
Total	444977050	452043048	-877025
Of which:			
Schools land not formally valued	28470800	37494703	-9023903
Total difference in estimation techniques			-9900928

- In future we recommend that the application of a blanket adjustment to the carrying value of a type of asset in not applied and that any revaluations are supported by a valuation certificate from the valuer.
- From our review of management's processes and assumptions for the calculation of the estimate, we are satisfied that this does not give rise to a risk of material misstatement.

Assessment

- We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant findings – key judgements and estimates

	Summary of management's policy	Audit Comments	Assessment
Net pension liability – £788.502m	The Council's total net pension liability at 31 March 2019 is £788.502 million (PY £802.463 million) comprising the Somerset Pension Fund Local Government and unfunded defined benefit pension scheme obligations. The Council uses Barnett Waddingham to provide actuarial valuations of the Council's assets and liabilities derived from these schemes. A full actuarial valuation is required every three years. The latest full actuarial valuation was completed in 2016. A roll forward approach is used in intervening periods, which utilises key assumptions such as life expectancy, discount rates, salary growth and investment returns. Given the significant value of the net pension fund liability, small changes in assumptions can result in significant valuation movements. There has been a £44.537 million net actuarial loss during 2018/19.	See below	● Green

Audit Comments:

- We identified the controls put in place by management to ensure that the pension fund liability is not materially misstated. We also assessed whether these controls were implemented as expected and whether they are sufficient to mitigate the risk of material misstatement. This included gaining assurances over the data provided to the actuary to ensure it was robust and consistent with our understanding. No issues were identified from our review of the controls in place.
- We also evaluated the competence, expertise and objectivity of the actuary who carried out your pension fund valuations and gained an understanding of the basis on which the valuations were carried out. This included undertaking procedures to confirm the reasonableness of the actuarial assumptions made

Assumption	Actuary Value	PwC range	Assessment
Discount rate	2.4%	2.4%-2.5%	● G
Pension increase rate	2.4%	2.4%-2.5%	● G
Salary growth	3.9%	Dependent on employer	● G
Life expectancy – Males currently aged 45 / 65	24.6 / 22.9	22.2-25 / 20.6-23.4	● G
Life expectancy – Females currently aged 45 / 65	25.8 / 24	25.0-26.6 / 23.2-24.8	● G

- We checked the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial reports and did not identified any inconsistencies.
- Our internal actuary has reviewed the impact of GMP equalisation judgement. For councils using Barnett Waddingham the impact is a potential overstatement of the net pension liability of 0.15% equating to £1.183 million for Somerset County Council. The Authority has considered that the impact of GMP equalisation is not material to the Statement of Accounts. Based on our review of this area we concur with this view.
- We are currently working through the McCloud adjustment to gain assurance that the basis is reasonable.

Assessment

- ● (red) We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- ● (amber) We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- ● (yellow) We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- ● (green) We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant findings – matters discussed with management

This section provides commentary on the significant matters we discussed with management during the course of the audit.

Significant matter	Commentary	Auditor View
Impact of the McCloud judgement The Court of Appeal has ruled that there was age discrimination in the judges and firefighters pension schemes where transitional protections were given to scheme members. The Government applied to the Supreme Court for permission to appeal this ruling, but this permission to appeal was rejected on the 26 June 2019. The case will now be remitted back to employment tribunal for remedy.	In light of this decision, which was made after the draft accounts were provided for audit, the Council requested from their actuary a full detailed IAS19 report to include an assessment of the McCloud liability. This has identified an additional liability as at 31 March 2019 of £13.168 million in relation to the McCloud adjustment of the Local Government Pension Scheme, with an additional projected service cost for 2019/20 of £1.153 million. The Council has adjusted for this in the final accounts.	We received the revised IAS 19 calculation from the Council on 18 July and are currently working through this to gain assurance that the basis of the adjustment is reasonable. We will provide an update on this to Committee members at the meeting on 30 July 2019.
School Land Assets revaluation In line with the code requirements the Council revalue assets on a five year rolling basis. Within each year 20% of the asset class is revalued and where this indicates material movement the remaining population is reviewed to identify any further movements that are necessary to be reflected in both the Fixed Asset Register and the Statement of Accounts	The Council has reviewed School land assets in line with its revaluation policy and noted that there are significant movements within the class of assets. This has been reviewed and, as a result of the movements, the assets not revalued in year have been adjusted downwards by 24%. This has resulted in a 9.0 million downward revaluation from approximately £37.4 million to approximately £28.5 million. The 24% adjustment is the average of the movements in the revalued assets and has been applied wholesale. As part of the audit process we have discussed the estimation technique with the valuer and with senior management. The valuer has confirmed that in his professional opinion the movement in valued assets is significant and that this will impact on all assets within that class.	We have reviewed the judgements made by the valuer in applying a downward revaluation of 24% to all non valued school land assets in 2018/19 and in our view do not consider it to be an appropriate approach. It is considered that the approach does not consider local factors for each individual asset when coming to a valuation. Further the average is not a weighted average and has not considered when assets were last valued. The downward valuation is not included within the valuer's report although confirmation has been received that the valuer believes that the approach is appropriate and in line with local factors. We have undertaken a separate review, using data supplied by an auditor's expert and have made our own estimate of a £100,000 increase in these assets since their last formal valuation, a difference of £9.0 million. We have considered this alongside other differences between our estimation of movements in your asset base against your estimation and are satisfied this does not give rise to a risk of material misstatement.

Significant findings - 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 material uncertainty disclosures

The Council faces significant financial challenges but we note the increased momentum in addressing these. This increases the risk of the need to disclose any material uncertainties that may cast doubt over the Council's ability to continue as a going concern in the financial statements. Given the sensitive nature of any disclosures, we have identified this as a key matter for the audit in our Audit Plan.

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. In her 'Assessment of Going Concern Status for the Statement of Accounts 2018/19' report dated the 21 June 2019 the Section 151 Officer concludes *'It is appropriate for Somerset County Council to produce its accounts on a going concern basis and no material uncertainties exist'.*	Management has concluded it remains a going concern and it is appropriate to continue to prepare its accounts on a going concern basis. We note that: • the Council has delivered 85% of its in year savings target and has managed the financial pressures faced to ensure expenditure remains within the approved budget. • the Council delivered an underspend of £5.9 million for 2018/19 and contributed a net £19.5m to general fund balances and earmarked reserves providing more resilience in this area • Management rebased the budget in September 2018 to address the ongoing financial challenges which also included the identification of a further £12 million in savings to address the forecast overspend • The budget setting processes for 2019/20 is considered more robust than previous years • The S151 Officer routinely monitors the Council's financial position and reports regularly to Members and SLT in which challenge is routinely demonstrated • Cash flow projections to not identity any risk of the inability of the Council to meet its financial responsibilities going forward
Work performed	**Auditor commentary**
We have reviewed the Section 151 Officer's going concern assessment and the MTFP. We have reviewed the associated disclosures in the financial statements.	• Our work confirmed that management's arrangements for assessing going concern are adequate and management's use of the going concern assumption as a basis for the preparation of the financial statements is reasonable • We have not identified any material uncertainties that may cast significant doubt on the Authority's ability to continue as a going concern for the foreseeable future.
Concluding comments	**Auditor commentary**
	• We concur with the S151 Officer's view that there are no material uncertainties that would require disclosure under ISA 570. • On the basis of our work, it is appropriate to issue an unmodified audit opinion on going concern.

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
1	**Matters in relation to fraud**	We have previously discussed the risk of fraud with the Audit Committee. We have not been made aware of any incidents in the period and no issues have been identified during the course of our audit procedures.
2	**Matters in relation to related parties**	We are not aware of any related parties or related party transactions which have not been disclosed.
3	**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 and we have not identified any incidences from our audit work.
4	**Written representations**	A standard letter of representation has been requested from the Authority, which is included in the Audit Committee papers.
5	**Confirmation requests from third parties**	• We requested from management permission to send confirmation requests for bank and investment balances. This permission was granted and the requests were sent. All of these requests were returned with positive confirmation. • 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.
6	**Disclosures**	Our review found no material omissions in the financial statements.
7	**Audit evidence and explanations/significant difficulties**	• All information and explanations requested from management were provided. • 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.

Other responsibilities under the Code

	Issue	Commentary
1	**Other information**	• We are required to give an opinion on whether the other information published together with the audited financial statements (including the Annual Governance Statement, Narrative Report and Pension Fund Financial Statements), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. No inconsistencies have been identified.
2	**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.
3	**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. • The deadline for completion of this work is 31 August 2019 and therefore this work is not complete at this stage. The findings of this will be reported to you in our Annual Audit Letter.
4	**Certification of the closure of the audit**	We are unable to certify the closure of the 2018/19 audit of Somerset County Council in the audit opinion, as detailed in Appendix E due to the following: • Outstanding VFM work in respect of demand lead budgets yet to be concluded (work due to complete by the 31 August 2019) • Whole of Government Accounts statement (deadline 31 August 2019) • Opinion on the consistency of the pension fund financial statements with the Pension Fund Annual Report (deadline 1 December 2019)

Value for Money

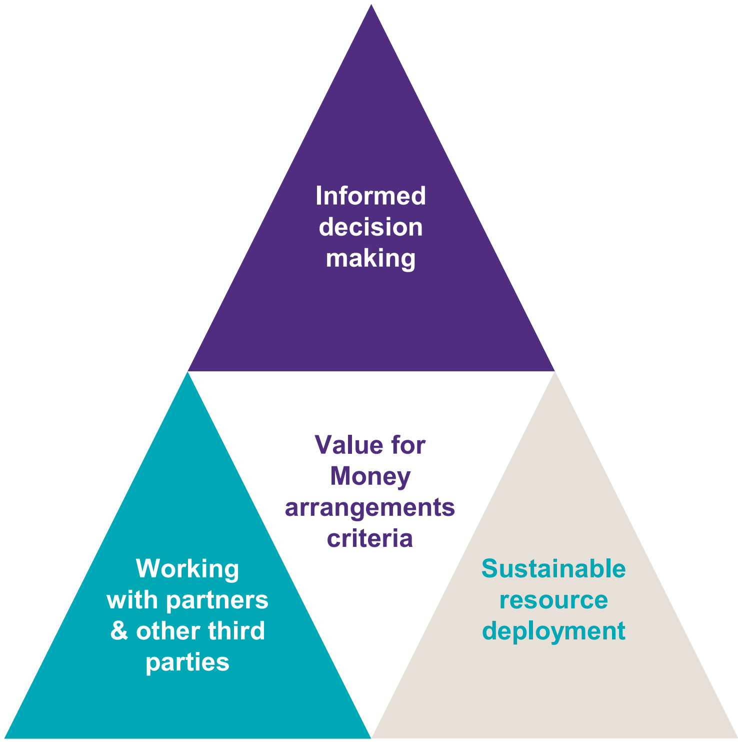
Background to our VFM approach

We are required to satisfy ourselves that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the Value for Money (VFM) conclusion.

We are required to carry out sufficient work to satisfy ourselves that proper arrangements are in place at the Council. In carrying out this work, we are required to follow the NAO's Auditor Guidance Note 3 (AGN 03) issued in November 2017. AGN 03 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 2018 and identified one significant risk in respect of Sustainable Resource Deployment: Future financial sustainability.

Specifically in our Audit Plan dated January 2019 we stated:

- In 2017/18 our work on Strategic Financial Planning concluded that the Council did not have proper arrangements in place to ensure sustainable resource deployment. Specifically, we reported that your financial health had deteriorated in year due to continued overspending, predominantly in the area of children and families. This necessitated further use of already depleted reserves that left the Council with limited capacity to fund any further overspending. On this basis we issued a qualified 'adverse' value for money conclusion and made seven value for money recommendations.
- Since our reporting last year we note the increased momentum aimed at addressing the budget challenges the council faces. In particular the greater focus on clear and timely budget monitoring, greater scrutiny and challenge and the rebasing of the children and families services budget to reflect more realistic cost pressure assumptions. We are also encouraged by the difficult decisions taken in September to make further savings. We note the continued improvement in projected 2018/19 revenue position to month 8, with the council now projecting a small underspend for the year.
- Despite this significant challenges remain. The improved in year position has been achieved, in part by non recurring savings, and the 2019/20 budget is estimated to require the delivery of £15m of further savings. Your level of reserves remain a concern and, although we recognise that the month 8 report states that they will be partially replenished in year, continued efforts are required to ensure that the council repositions itself on a sustainable financial footing.
- We will review the actions taken in response to our recommendations last year.
- We will review monitoring arrangements, including the robustness of the Council's Medium Term Financial Plan, the delivery of the 2018/19 budget, and the action taken when plans are not being delivered.

We have continued our review of relevant documents up to the date of this report, and have not identified any further significant risks where we need to perform further work.

Value for Money

VFM work undertaken during the year

Given the qualified 'adverse' value for money conclusion last year we have committed significant time and resource to engaging with the Council at all levels to gain a full understanding of the changes being implemented to address our concerns.

During the audit year we have provided regular challenge and feedback to the senior leadership within the Council on progress against our 7 recommendations arising from our review last year. We have also provided regular feedback to the Audit Committee as Those Charged with Governance via our progress reports.

Our work has focused on, but has not been limited to assessing:

- How budget setting, monitoring and outturn reports facilitate challenge of and delivery against budget;
- Whether budget setting is sufficiently robust to set a realistic and achievable budget based on the requirements of demand led services and with regard to prior year performance and outturn;
- The consistency between the original revenue budget and in-year financial monitoring including clear reporting on the delivery of savings that facilitate challenge and corrective action where overspends are identified;
- The robustness of challenge to in-year financial monitoring reports and action taken in response to in-year overspends and ensuring these are appropriately evidenced;
- The adequacy of year end financial reporting to members to 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;
- The compliance with the Capital flexibilities guidelines requiring all identified projects to be included in the budget process and approved prior to the financial year along with achievement against prior year projects;
- The adequacy of the annual Section 25 assessment by the Director of Finance with regard to the adequacy of both general fund and earmarked reserves including any proposed actions to strengthen these going forward; and
- The consideration of the appropriateness of holding negative earmarked reserves.

Improvements in arrangements

Since our report in July 2018 we have seen improvements in the Council's arrangements to deliver sustainable resource deployment. Specifically:

- Improved in year reporting of performance against the budget, facilitating understanding and challenge where appropriate to delivering the budget (better narrative including more explanation of variations, details on the use of capital flexibilities and descriptions of corrective action to be taken)
- Recognition that the original 2018/19 budget was not fit for purpose and required rebasing to combat forecast overspend in Children Services part way through the financial year (clear evidence of the Council grasping the challenge and recognising the need to make the difficult decisions to bring the budget back in line resulting in an additional £15.9m of funding going into Children Services mid-year)
- Taking the difficult decision to introduce further savings in year (MTFP2) to ensure delivery against budget
- Improved identification, monitoring and delivery of budget and both savings plans (MTFP1+2) including clear evidence of timely challenge to variances and holding budget holders to account
- Clearer communication of delivery in year within the 2018/19 outturn report to Cabinet in June including where savings have been made, revenue savings note, greater detail on capital flexibilities etc.
- More robust approach to setting a realistic and achievable budget for 2019/20 including appropriate consideration of the latest outturn projections in 2018/19. The budget includes all expected known pressures such as realistic allowances for pay awards that were absent from previous budgets
- Greater focus on the basis of the MTFP with further contributions to reserves being set-aside and clearer identification of savings to address budget gaps

Progress against the 7 prior year recommendations are set out in Appendix B on pages 21 to 26.

Preliminary Findings

The improvements set out on the previous page have facilitated a much improved outturn position for 2018/19 with the Council reporting a overall underspend against budget of £5.9 million. This underspend masks a greater underspend that has enabled the Council to increase the combined value of its general fund balances and earmarked reserves by a total of £20.4 million over the last 12 months providing more resilience in this area.

Elements of this total underspend were as a result of a combination of: non-recurring; one-off; technical savings (e.g. minimum revenue provision totalling £4.2m benefit in 2018/19); additional use of the capital flexibilities (which was budgeted at £2.6 million but £8.6 million used), and; unplanned additional central government income (including £2.5 million extra adult social care funding). This nonetheless marks a significant step in the Council's turnaround plan and stops a trend of annual overspends seen in recent years.

	31.3.18 £000's	**31.3.19 £000's**	**Movement £000's**
General Fund (excluding schools)	20,929	17,689	-3,240
Earmarked reserves	2,820	26,494	23,674
TOTAL	**23,749**	**44,183**	**20,434**

Within the earmarked reserves total of £26.5 million at 31March 2019 is £10.2 million of negative earmarked reserves, a reduction from £19.5 million in the previous year. The largest of these is the Dedicated Schools Grant (DSG) with a cumulative deficit of £6.7 million, up from £3.9 million in the previous year. Despite the Council having submitted the required DSG Three-year Deficit Recovery Plan to the Department for Education (on 28 June 2019) that sets out the plans to recover this deficit, the increasing deficit against this reserve remains a concern and places further pressure on the already depleted financial position of the Council.

Our VFM conclusion covers the whole of 2018/19 and we note that at the start of the 2018/19 year it was the poor budget setting process that resulted in the need for reactive emergency measures to identify and deliver further savings to balance the budget

Clearly for a number of the weaknesses identified in arrangements in our report in July 2018 could not have been fully addressed in the intervening 10 months and the Council will only be able demonstrate improvements against all areas over an extended period of time.

Our commentary against the recommendations made last year, detailed in Appendix B pages 20 to 26, highlight progress but also further scope to strengthen arrangements going forward.

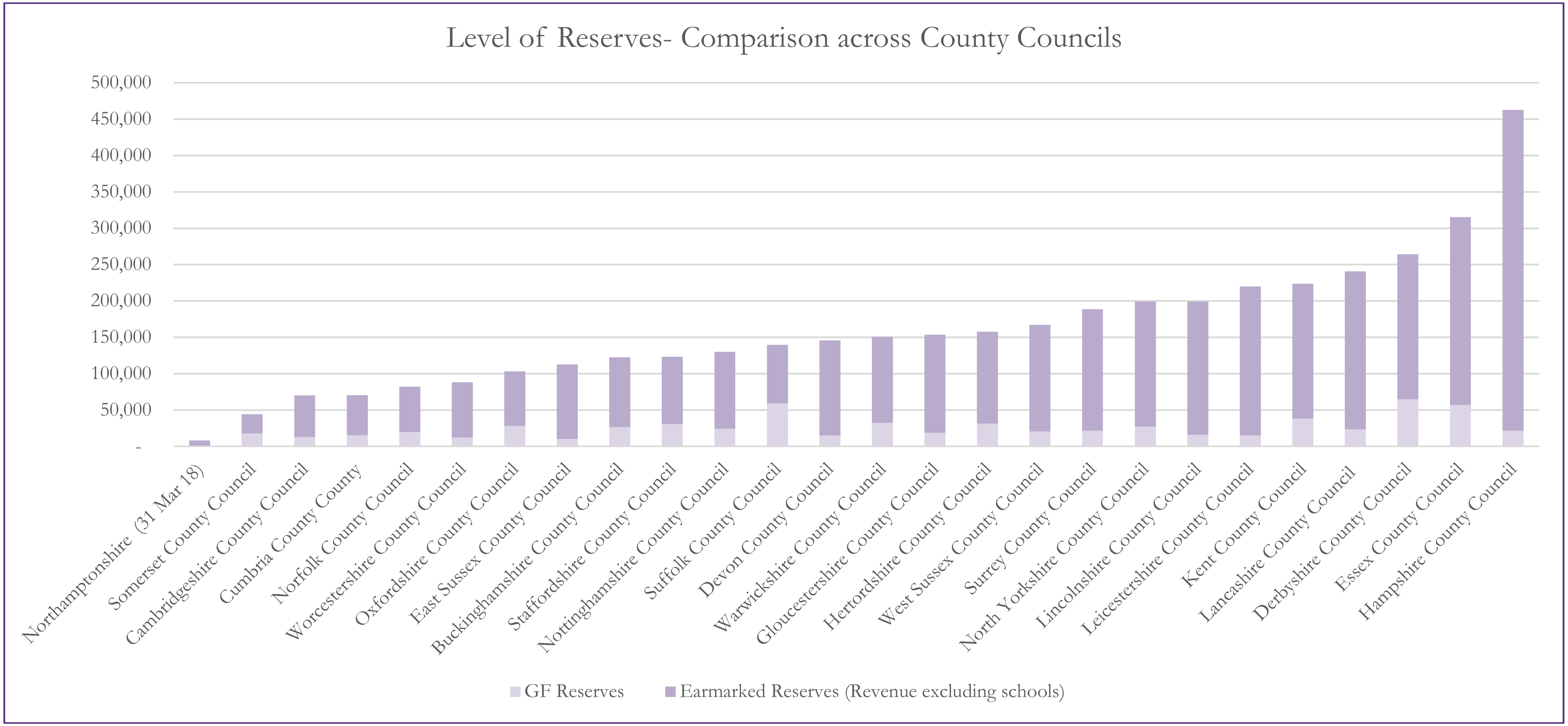
Internal Audit in their Healthy Organisation Report of January 2019 also identified within its financial management section, which was given an 'amber' rating areas of improvement over the last 12 months but also recognised further areas for attention.

The Corporate Peer Challenge: Follow up Visit of April 2019 commented on the Council's positive response to it's financial challenges indicating it has faced these with 'vigor', also noting the marked improvement in its financial position. The report went on to highlight that in their view, the future demand and growth forecasts into the medium term seemed relatively modest.

In our view, the improvement in the total level of general fund and earmarked reserves has only gone so far in restoring the balance sheet to a position that provides resilience into the medium term. The low level of earmarked reserves compared with peers still provides limited capacity to absorb any unexpected future financial pressures (see table on next page) and this remains an area of concern.

However, biggest continued concern we have as your auditors remains the ability of the Council to balance its books into the medium term. Our high level analysis of the budget allocations to both Children Services and Adults Services across the MTFP indicates low levels of growth over the next 3 years in both areas and reflects the impact of increased debt charges (principal and interest) restricting the ability of the Council to increase budgets in line with historic annual increases in spend.

VFM work undertaken during the year (continued)



Source: individual councils' unaudited financial statements for 2018/19 from individual council websites

Please note: these figures do reflect inconsistent treatment of any DSG deficit treatment at individual councils

Completion of the VFM audit

In order to arrive at the appropriate VFM conclusion for 2018/19 we are now seeking more assurances over the embeddedness of the improvement arrangements. We recognise the good progress that has been made over the last 10 months but also note that reserves and balances, despite the increases in year, provide limited resilience should significant overspends emerge in the future.

This risk of future overspends, in our experience, is a particular risk at county councils given their limited ability to raise additional income but also given that a significant and generally increasing percentage of their total spend is take up funding social care which continues to be under increasing pressure due to demand and unit cost increases.

We therefore want to, before issuing our VFM conclusion for 2018/19, gain more confidence over the robustness of the Council's MTFP and in particular the deliverability of the Children Services and Adults Services budgets through to 2021/22.

We have therefore asked our social care colleagues from our Public Sector Advisory team to act as 'auditor's experts' and provide us with their assessment of the robustness and realism of the Children's and Adult Social Care annual budgets within the Council's MTFP. The review to include consideration of the robustness of savings plans.

As a result of this proposed additional work we are unable to conclude our VFM conclusion by 31 July 2019. Our auditors expert are aiming to complete this work by the end of August 2019 and we proposed to use their findings to inform our final VFM conclusion for 2018/19 that will be reported to the Audit Committee at their September 2019 meeting.

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Statutory Recommendation

Our report last year also highlighted the possibility of issuing a statutory recommendation should the Council not have changed and implemented improvements in arrangements over the last 10 months and performance not improved. We are pleased to report that the improvements seen since July 2018 now mean that the risk of us having to issue such a recommendation has reduced significantly.

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 identified two recommendations for the Council as a result of issues identified during the course of our audit. We have agreed our recommendations with management and we will report on progress on these recommendations during the course of the 2019/20 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.

As set out on page 18 our work in respect of the VFM conclusion continues and we will issue our updated VFM recommendations following the completion of this work.

	Assessment	Issue and risk	Recommendations
1	● M	**Journals** **Testing of journals identified that officers have the ability to post and authorize their own journals. There is a risk of potentially fraudulent journals being posted.**	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 **Management response** 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 staff only. (These are very rarely AR and AP users). Key journals have other controls – in particular accruals over £25k actually need to be signed off by a Strategic Manager before being processed. As an additional control due to the isolated errors noted in the audit testing Corporate Finance will carry out an additional check during the closing of the accounts for 2019/20 to ensure all accruals are correct and legitimate and to ensure that the errs found were isolated. 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. SCC has provided a full journal list to Grant Thornton for SCC and a small number of examples tested were found to contain errors or be processed erroneously and none have been found to be fraudulent. 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

Action plan continued

	Assessment	Issue and risk	Recommendations
2	● M	**Property, Plant and Equipment valuation** • On advice from the Council's valuer, a 24% downward revaluation has been applied to all school land assets not subject to a formal revaluation in the year to recognise the reductions identified in similar assets valued in year. • This has not been based on a formal revaluation and in our opinion, is not appropriate basis for revaluing these assets as the reduction does not consider the specific factors of each asset individually in arriving at the appropriate carrying value.	That the application of a blanket adjustment to the carrying value of a type of asset is not applied and that any revaluations are supported by a valuation certificate from the valuer for each individual asset. **Management response** The authority's valuations are split into a cross cutting 5 year cycle ensuring a representative sample of the entire portfolio is valued each year. This allows the Authority to consider, and where necessary apply, any market movements that our professional valuer deems significant. In this instance the schools land population had varying degrees of movements due to specific and generic factors. The application of a downward 24% based on the average movements is felt to be applicable across the remaining section of the portfolio and thus representing the current value, in total, on the balance sheet. The authority accept the consideration this application may not be wholly relevant on an individual asset basis; however, it was not practical to revalue each asset within the narrow timescale available and a 'do nothing' approach would have potentially left the balance sheet in an overstated position. The Authority will consider possible methods to apply when any future movements arise.

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 issues in the audit of Somerset County Council's 2017/18 financial statements, which resulted in 8 recommendations being reported in our 2017/18 Audit Findings report, the first 7 of which related to our adverse VFM conclusion. We set out below progress against each of these recommendation.

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue and recommendations
✓	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.	• The Council has reviewed and updated the format of the financial information reported to officers and members iteratively over the last 10 months. It is noted that the reports now include greater detail on overspends and the reason for them as well as tracking of delivery of the savings programmes, projected outturn and the likely year end reserve position. • Detailed financial information is provided to a wider cohort of forums including the relevant scrutiny committees for consideration of the financial performance in demand led services which are subject to the greatest amount of pressure. • Each in-year revenue budget monitoring report includes a 'headline summary table' in this appendix. Whilst this table is now much better with more detail than in previous years, for example providing movement from the previous report, it is our view not easy to interpreted how, for example, the 'non-service item (including Debt Charges)' line is reallocated over the service headings as the year progresses. • The 2018/19 revenue budget outturn report is much improved on the previous year providing recipients with a more transparent assessment of the true in year performance. We note that a further revision to the in-year revenue budget monitoring report effective from M2 2019/20 to provide more explanation around the table in the appendix. **Conclusion** • Good progress has been made in addressing this recommendation. • Going forward the Council should consult further with the recipients of its financial reports to determine whether they provide information in a digestible way, with the right level of detail and whether any areas require further refinement to fully inform future decision making. This may be facilitated through a workshop where decision makers have the opportunity to seek clarity on and aspects of the financial reporting they don't understand or where they believe the format could be improved.

Assessment
✓ Action completed
P Partially addressed
X Not yet addressed

Follow up of prior year recommendations

We identified the following issues in the audit of Somerset County Council's 2017/18 financial statements, which resulted in 8 recommendations being reported in our 2017/18 Audit Findings report, the first 7 of which related to our adverse VFM conclusion. We set out below progress against each of these recommendation.

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
TBC	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.	**2018/19** • The month 2 forecast for 2018/19 identified a forecast £12.1m overspend that required senior management to review the appropriateness of the budget. This resulted in a rebasing of the budget in September 2018 with significant adjustments to both Children's and Adult Services, although there was no overall impact on the net budget requirement. The budget set in February 2018 was clearly not fit for purpose and required significant reworking including the identification of an extra £12m in savings to address the overspend. • In the early part of 2018/19 the Council was facing another significant overspend but unlike previous years it 'grasped the nettle' and took decisive action, taking the difficult decision to make additional in-year cuts to deliver the savings necessary to regain financial control. **2019/20** • The 2019/20 budget has been extensively reviewed and is much more robust. The Council have set a more realistic and achievable budget including appropriate consideration of the latest available outturn projections in 2018/19. The budget includes all expected known cost pressures such as realistic allowances for pay awards, reasonable growth in the demand lead areas of Children's and Adult Services that were absent from previous budgets. Appropriate consideration was given to potential future income flows and the budget includes a contingency of £7.2 million to provide resilience. For Children's, where the greatest inherent risk remains, the Council have been working with Peopletoo Ltd to ensure appropriate challenge to assumptions as well as to look at service redesign. • **MTFP** The process for producing the MTFP has been reviewed to ensure, as with the annual budget, that all known pressures and savings requirements are included, thus ensuring a realistic picture of what the future costs to the Council are. The MTFP has also be constructed in such as way as to reduce the requirement for support through contingency and to recognise the increasing costs of servicing debt and the costs associated with pay awards. • The Council continues to hold a contingency within the annual budget to provide resilience during the year. The contingency for 2018/19 of £7.2 million reduces over the life of the MTFP to £4.1 million in 2021/22 and beyond. • As set out on page 18 additional work is proposed in this area to further assess the robustness of both the 2019/20 budget and the MTFP in the high risk service areas of Children's and Adult Services. **Conclusion** Good progress has been made in improving the annual budget setting process. The further work planned in this area and to be reported back to the September 2019 Audit Committee will provide a more detailed assessment on the robustness of the budgets for Children's and Adult Services.

Assessment
✓ Action completed
P Partially addressed
X Not yet addressed
TBC To be confirmed

Follow up of prior year recommendations

We identified the following issues in the audit of Somerset County Council's 2017/18 financial statements, which resulted in 8 recommendations being reported in our 2017/18 Audit Findings report, the first 7 of which related to our adverse VFM conclusion. We set out below progress against each of these recommendation.

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
✓	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	• Our review of the revised budget for 2018/19 and the in-year revenue budget monitoring reports indicates greater consistency between these documents. We note that the 2018/19 financial year saw some large variations in adjustments to the projected outturn position throughout the year, particularly in the area of capital flexibilities and contributions to and from reserves. • The delivery of savings is a key element of the Council's Financial Imperative Programme. In the in-year revenue budget monitoring reports detail on the delivery of savings is now much more comprehensive. • Our attendance at a joint meeting of Cabinet and SLT indicated a good level of scrutiny and challenge to delivery, focusing on variances against plan and savings. Budgets and savings targets are now subject to increased scrutiny across the organisation, with savings being reported to members via Cabinet, the Audit Committee and Scrutiny meetings. During the critical mid part of 2018/19 SLT were receiving weekly updates (now fortnightly) and there is greater evidence of budget holders being held to account locally. This has been facilitated through the budget management face to face workshops aimed at improving understanding and accountability. • Delivery of savings in 2018/19 is much improved despite the September 2018 rebased budget introducing a further £12.1 million on in year savings (MTFP2). Overall delivery of savings in 2018/19 was 85%, made up of 72% of MTFP1 and 95% of MTFP2. • The Council has also taken the decision to report savings on a service level rather than on a thematic basis which in our view has facilitated challenge and holding budget holders to account for delivery. **Conclusion** Good progress has been made in addressing this recommendation with the approach to the identification and delivery of savings much more robust.

Assessment
✓ Action completed
P Partially addressed
X Not yet addressed

Follow up of prior year recommendations

We identified the following issues in the audit of Somerset County Council's 2017/18 financial statements, which resulted in 8 recommendations being reported in our 2017/18 Audit Findings report, the first 7 of which related to our adverse VFM conclusion. We set out below progress against each of these recommendation.

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
✓	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.	• Although we are not present at SLT or Cabinet our review of minutes indicate increased documentation around financial delivery and where appropriate challenge and any resulting agreed action. • The attendance, for example, of the Director of Childrens Services along with the then Interim Director of Finance at a Scrutiny for Policies and Place Committee to provide assurance first hand on improved financial control in Childrens Services provides further evidence of accountability. • We attended, as an observer, the December 2018 Cabinet and Senior Leadership Team meeting. We observed constructive challenge to the projections and assumptions both for the 2018/19 and the draft 2019/20 budget. **Conclusion** Good progress has been made in addressing this recommendation with clear evidence of rigour in the challenge, at all levels of the organisation, of the budget position.

Assessment
✓ Action completed
P Partially addressed
X Not yet addressed

Follow up of prior year recommendations

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
P	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.	• The 2018/19 revenue budget outturn report is much improved on the previous year. The report is very explicit about the iterative improvements in projected outturn during the year, provides good level of details on balances and reserves including transfers, the use of capital flexibilities, savings performance as well as forward looking narrative on the challenges ahead. • We note that the report does, however, continue to record different levels of General Fund balances £16.366 million compared with the draft financial statements presented for audit £17.689 million. • Further information on projected balances, reserves and outturn amongst others has been communicated via a number of forums including, for example, the presentation by the Interim Director of Finance to Closed Cabinet on 1 April 2019. **Conclusion** Although good progress has been made in improving the year end financial reporting we remain very much of the view that the internal financial reporting should mirror the year end financial position reported in the financial statements. .
P	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	• There has been more detail provided on the use of capital flexibilities in the in year financial monitoring reports supplemented with information on prior year projects in the 2018/19 revenue budget outturn report that included reference the business cases supporting them. However, there has yet to be consideration of outcomes against the planned projects that is a requirement of the guidelines. • Given the significant increase in the actual application of capital flexibilities applied in 2018/19, totaling £8.6 million against the original budgeted use of just £2.6 million more information should be disclosed going forward. **Conclusion** • Again, as in 2017/18, the Council have complied with the spirit of the flexibilities. Disclosures on the nature of transformation has improved but there is still work to be undertaken to ensure full compliance.

Assessment
✓ Action completed
P Partially addressed
X Not yet addressed

Follow up of prior year recommendations

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
P	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.	• The then S151 officer has provided in his Section 25 report a more detailed analysis of his view on the adequacy of reserves both in terms of general fund and importantly earmarked reserves. It highlighted that these were of an acceptable level given the Council's strategy to strengthen them into the medium term. • Negative Earmarked reserves – The Council has reduced the number and the value of its negative earmarked reserves from £19.7 million at 31 March 2018 to £10.2 million at 31 March 2019. Its large negative earmarked reserve is the Dedicated Schools Grant (DSG) with a cumulative deficit of £6.7 million which is shown under earmarked reserves. CIPFA and the Department for Education have issued a joint statement on DSG for 2018/19. The statement confirms that there is no statutory basis for having a negative earmarked DSG reserve. The Council recognises this is something that is ultimately a further pressure on its financial health should the proposed recovery plan (submitted to the Department for Education in accordance with guidelines on 28 June 2019) not deliver. The statement also confirms the guidance in LAAP bulletin 99 Local Authority Reserves and Balances remains extant i.e. it "neither anticipates nor allows for a voluntary earmarked balance to be presented in a deficit position." • We recommend the Council continue to work to remove all negative earmarked reserves including the DSG negative reserve within earmarked reserves. **Conclusion** The Section 25 report from the then S151 officer this year is much improved. The Council has made good progress in reducing the value of its negative earmarked reserves but the increasing deficit against the DSG reserve remains a concern and places further pressure on the already depleted financial position.
X	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.	• As in prior years finance officers believe there are sufficient controls in place to mitigate the risk and have therefore declined to amend the process. This risk and recommendation will be included in 2018/19 Audit Findings Report

Assessment
✓ Action completed
P Partially addressed
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

All adjusted misstatements are set out in detail below along with the impact on the key statements and the reported net expenditure for the year ending 31 March 2019.

	Detail	Comprehensive Income and Expenditure Statement £'000	Balance Sheet £' 000	Impact on total net expenditure £'000
1	Waste contract discount included as income and should have been netted off against expenditure. Therefore both gross income and expenditure are overstated within the CIES	£1,300 (£1,300)		£0
2	The McCloud ruling has required the recognition of further liabilities meaning that the total comprehensive income and expenditure figure is overstated. The charges to the CIES were reversed to the Pension Reserve through the Movement in Reserves Statement. A number of notes to the financial statements were also updated to reflect the updated transactions and balances	£13,168		£13,168
3	The McCloud ruling has required the recognition of further liabilities meaning that other long term liabilities and unusable reserves are both understated		(£13,168) (£13,168)	£0
	Overall impact	**£13,168**	**(£13,168)**	**£13,168**

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?
Revaluations – Asset valuation by year	• The Authority undertakes revaluation of assets on a five year cyclical basis. Disclosures require an analysis of the total value of assets valued in a financial year. The original table covered six years which is outside of the Code requirements of a five year cycle with the value of those assets reviewed six years ago being £8.849m	• The Authority should review and revise the table to ensure that it shows only five years in line with the requirements of the code	✓
Material Items of Income and Expenditure	• As part of segmental reporting the Authority have included transactions with other operating segments of the authority through internal recharge. These do not form part of the I&E statement and therefore are incorrectly disclosed. The value of these is £72.105m	• The Authority should remove the transactions with other operating segments of the authority from the segmental analysis	✓
Senior Officer remuneration	• The disclosure of the Director of Finance and Performance within the Senior Officer remuneration table has incorrectly included £3,700 in employer's NI	• The Authority should remove the Employer's NI element from the Director of Finance and Performance disclosure	✓
Expenditure Funding Analysis (EFA)	• The EFA should agree to the figures reported to members as part of the financial outturn to the net expenditure figure reported in the CIES. This requires further disclosures within the note over and above that already disclosed by the Authority	• The Authority should update the table to include the extra disclosure requirements to demonstrate the reconciliation between the CIES and the figures reported to members. This should also include extra narrative within note 7	✓
Financial Instruments	• The Council has categorised money market funds as being held at amortised cost, however our audit testing has identified that these should be categorised as fair value through profit and loss. The Council holds £34.925 million of money market funds which need to be reclassified.	• The Authority should review and update the note to ensure compliance with the updated requirements of the code	✓
McCloud Judgement	• The adjusted misstatements as a result of the McCloud judgement have been recorded on the previous page. There are a number of disclosure notes within the statements that require adjustment as a result of the ruling and the updated IAS19 calculations. These disclosures have been reviewed and the appropriate adjustments have been made	• The Authority should review the disclosure notes impacted by the McCloud judgement and update accordingly.	✓

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?
Fair Value of Scheme Assets	• The Code requires that assets should be disaggregated between those that are quoted and those that are unquoted	• The Authority should disaggregate the scheme assets between quoted and unquoted	✓
IFRS9 Accounting Policy	• There has been a change in accounting standards as a result of IFRS 9 that has amended the reporting of financial instruments. As there has been a change in year the comparative figures are calculated under the previous standard of IAS39 and as such the prior year policy should be disclosed	• The authority should include the 2017/18 IAS39 policy to cover the calculation of the prior year comparators	✓
Exit Packages	• There are 3 duplicate entries for teacher's with a total value of £16,000 which are disclosed within notes 19 and 20.	• The Authority should remove duplicate entries to ensure the disclosures accurately reflect the exit packages provided in year	
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	✓

Audit Adjustments

Impact of unadjusted misstatements

The table below provides details of adjustments identified during the 2018/19 audit which have not been made within the final set of financial statements. The Somerset County Council Audit Committee is required to approve management's proposed treatment of all items recorded within the table below:

	Detail	Comprehensive Income and Expenditure Statement £'000	Balance Sheet £' 000	Impact on total net expenditure £'000	Reason for not adjusting
1	Testing of a creditor accrual of £558k to supporting evidence identified that the value was £904k. The variance is due to the Authority removing £346k of internal recharges which they were unable to evidence. Therefore creditors are potentially understated and the error has been extrapolated.		(1,900)	(1,900)	Not material individually or in total and is an extrapolated figure
2	Our review of the PPE valuation identified a £9.0 million error resulting from, what in our view is, an inappropriate revaluation of a group of schools land by a blanket 24%. The Council has decide not to adjust for this and we are satisfied that this is not material to the overall financial statements.		(9,024)		Not material individually or in total
3	Our internal actuary has reviewed the impact of GMP equalisation judgement. For councils using Barnett Waddingham the impact is a potential overstatement of the net pension liability of 0.15% equating to £1.183 million for Somerset County Council. The Authority has considered that the impact of GMP equalisation is not material to the Statement of Accounts. Based on our review of this area we concur with this view.		1,183		Not material individually or in total
	Overall impact		**(9,741)**	**(1,900)**	**Not material**

Fees

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

Audit Fees

Our Audit Plan included a PSAA published scale fee for 2018/19 of £76,902. Our audit approach, including the risk assessment, continues as the year progresses and fees are reviewed and updated as necessary as our work progresses.

Update to our risk assessment – Additional work in respect of the audit code

The table below sets out the additional work which we have undertaken to complete the audit, along with the impact on the audit fee where possible. Please note that these proposed additional fees are estimates based on our best projection of work and will be subject to approval by PSAA in line with the Terms of Appointment.

Estimated additional Audit Fees

Area of work	Timing	Comment	£
Assessing the impact of the McCloud Ruling	June – July 2019	The Government's transitional arrangements for pensions were ruled discriminatory by the Court of Appeal last December. The Supreme Court refused the Government's application for permission to appeal this ruling. As part of our audit we considered the impact on the financial statement along with any audit reporting requirements. This included consultation with our own internal actuary in their capacity as an auditor expert.	3,000
Pensions – IAS 19	June-July 2019	The Financial Reporting Council has highlighted that the quality of work by audit firms in respect of IAS 19 needs to improve across local government audits. Accordingly, we have increased the level of scope and coverage in respect of IAS 19 this year.	3,000
PPE Valuation – work of experts	June-July 2019	As above, the Financial Reporting Council has highlighted that auditors need to improve the quality of work on PPE Valuations across the sector. We have increased the volume and scope of our audit work to reflect this.	3,000
VFM conclusion a) The audit team b) The auditors expert	Sept 2018-July 2019 August 2019	Additional scrutiny of VFM financial resilience arrangements during the 2018/19 audit cycle including monthly meetings with the Director of Finance	10,800 tbc

Total Audit Fees

Audit *fee*	Actual 2017/18 fee £	Planned 2018/19 fee £	Final 2018/19 fee £
Council Audit	99,873	76,902	76,902
Additional Audit Fee (see above)	11,336	TBC	TBC
Total audit fees (excl VAT)	**111,209**	**TBC**	**TBC**

Non Audit Fees

Fees for other services	Fees £
Audit related services:	
Certification Audit	7,950
Total fees for other services	**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 2019 which comprise the Comprehensive Income and Expenditure Statement, Movement in Reserves Statement, the Balance Sheet and the Cash Flow Statement and notes to the financial statements, including the statement of 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 2018/19.

In our opinion, the financial statements:

- give a true and fair view of the financial position of the Authority as at 31 March 2019 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 2018/19; 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.

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, other than the financial statements, our auditor's report thereon and our auditor's report on the pension fund financial statements. 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 audit 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.

Draft Audit opinion

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.

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, the other information published together with the financial statements in the Statement of Accounts 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 issue a report 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 make 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 make an application to the court for a declaration that an item of account is contrary to law under Section 28 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or;
- we issue an advisory notice under Section 29 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or
- we make an application for judicial review under Section 31 of the Local Audit and Accountability Act 2014, in the course of, or at the conclusion of the audit.

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

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

As explained more fully in the Statement of Responsibilities set out on page 15, 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 Financial Officer. The Chief Financial 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 2018/19, for being satisfied that they give a true and fair view, and for such internal control as the Chief Financial 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 Financial 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 there is an intention by government that the services provided by the Authority will no longer be provided.

The Audit Committee is Those Charged with Governance. Those charged with governance are responsible for overseeing the Authority's financial reporting process.

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.

Draft Audit opinion

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

We cannot formally conclude the audit and issue an audit certificate for the Authority for the year ended 31 March 2019 in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice until we have :

- given our conclusion on the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources. We are unable to issue our conclusion until we have completed our consideration of matters that have been brought to our attention. We are satisfied that this matter does not have a material effect on the financial statements for the year ended 31 March 2019.
- given an opinion on the consistency of the pension fund financial statements of the Authority included in the Pension Fund Annual Report with the pension fund financial statements included in the Statement of Accounts. The Local Government Pension Scheme Regulations 2013 require authorities to publish the Pension Fund Annual Report by 1 December 2019. As the Authority has not prepared the Pension Fund Annual Report at the time of this report we have yet to issue our report on the consistency of the pension fund financial statements.
- completed the work necessary to issue our Whole of Government Accounts (WGA) Component Assurance statement for the Authority for the year ended 31 March 2019.

We are satisfied that this work does not have a material effect on the financial statements for the year ended 31 March 2019.

Use of our report

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.

[Signature]

Peter Barber
Key Audit Partner
for and on behalf of Grant Thornton UK LLP, Local Auditor

[Date]