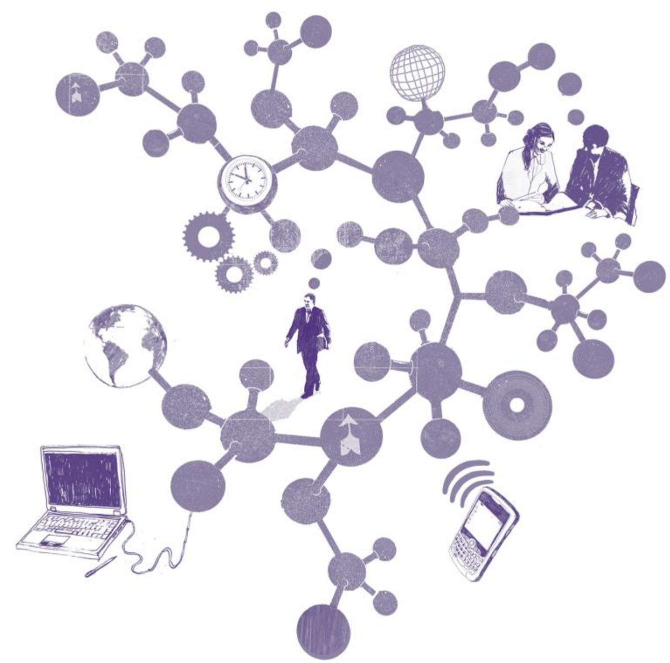
Grant Thornton

The Annual Audit Letter for Worcestershire County Council

Year ended 31 March 2016

October 2016



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Executive summary

Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Worcestershire County Council (the Council) for the year ended 31 March 2016.

This Letter is intended to provide a commentary on the results of our work to the Council and its external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice (the Code) and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'.

We reported the detailed findings from our audit work to the Council's Audit and Governance Committee as those charged with governance in our Audit Findings Report on 21 July 2016.

Our responsibilities

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

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

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

Our work

Financial statements opinion

We gave an unqualified opinion on both the Council's financial statements and those of the Pension Fund on 28 July 2016.

Value for money conclusion

We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources during the year ended 31 March 2016. We reflected this in our audit opinion on 28 July 2016.

Whole of government accounts

We completed work on the Council's consolidation return following guidance issued by the NAO and issued an unqualified report on 18 October 2016

Certificate

We certified that we had completed the audit of the accounts of Worcestershire County Council in accordance with the requirements of the Code on 21 October 2016.

Working with the Council

We have continued to work collaboratively with you during the year ensuring a smooth and efficient audit delivered well in advance of the statutory deadline. Where appropriate we have shared our knowledge, through either thought leadership or by providing training and briefing materials on key accounting issues. Officers have benefited from attending a number of seminars and workshops, and have gained access to CFO insights, our online analysis tool.

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

Grant Thornton UK LLP
October 2016

Audit of the accounts

Our audit approach

Materiality

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

We determined materiality for our audit of the Council's accounts to be £15.516m, which is 2% of the Council's gross revenue expenditure. We used this benchmark, as in our view, users of the Council's accounts are most interested in how it has spent the income it has raised from taxation and grants during the year.

We also set a lower level of specific materiality for certain areas such as senior officer remuneration and the disclosure of the audit fee.

We set a lower threshold of £775,800, above which we reported errors to the Audit and Governance Committee in our Audit Findings Report.

Pension Fund

For the audit of the Worcestershire Pension Fund accounts, we determined materiality to be £19.873. which is 1% of the Fund's net assets. We used this benchmark, as in our view, users of the Pension Fund accounts are most interested in the value of assets available to fund pension benefits.

We set a lower level of specific materiality for certain areas such as management expenses and related party transactions. We set a threshold of £994,000 above which we reported errors to the Audit and Governance Committee.

The scope of our audit

Our audit involves obtaining enough evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error.

This includes assessing whether:

- the Council's accounting policies are appropriate, have been consistently applied and adequately disclosed;
- significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the narrative report and annual governance statement to check they are consistent with our understanding of the Council and with the accounts on which we give our opinion.

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

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

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the accounts - Council

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

Risks identified in our audit plan	How we responded to the risk
The revenue cycle includes fraudulent transactions Under ISA (UK&I) 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.	Having considered the risk factors set out in ISA240 and the nature of the revenue streams at Worcestershire County Council, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited; and • the culture and ethical frameworks of local authorities, including Worcestershire County Council, mean that all forms of fraud are seen as unacceptable. Our audit work has not identified any issues in respect of revenue recognition.
Management over-ride of controls Under ISA (UK&I) 240 it is presumed that the risk of management over-ride of controls is present in all entities.	As part of our audit work we have: • reviewed the accounting estimates, judgements and decisions made by management, • tested journal entries, and • reviewed unusual significant transactions. Our audit work has not identified any evidence of management over-ride of controls. In particular the findings of our review of journal controls and testing of journal entries has not identified any significant issues.

Audit of the accounts - Council

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

Risks identified in our audit plan	How we responded to the risk
Valuation of property, plant and equipment The Council revalues its assets on a rolling basis over a five year period. The Code requires that the Council ensures that the carrying value at the balance sheet date is not materially different from the current value. This represents a significant estimate by management in the financial statements.	As part of our audit work we have: • reviewed the competence, expertise and objectivity of any management experts used, • reviewed management's processes and assumptions used for the calculation of the estimate, • reviewed the instructions issued to valuation experts and the scope of their work, • discussed with the valuer the basis on which the valuation was carried out and challenged the key assumptions, • reviewed and challenged the information used by the valuer to ensure it was robust and consistent with our understanding, • tested revaluations made during the year to ensure they were input correctly into the Council's asset register, and • evaluated the assumptions made by management for those assets not revalued during the year and how management satisfied themselves that these were not materially different to current value. This is the first year that the Council has used PPL to value its assets, and there have been some teething problems in ensuring the correct information is provided in a timely manner. The formal valuation report was not available for the start of the audit fieldwork, nor was the evaluation of how management had satisfied themselves that for assets not revalued during the year there was no material difference to the current value held on the balance sheet. Further work was required by officers to provide appropriate assurance that assets not revalued in year were not materially misstated.
Valuation of pension fund net liability The Council's pension fund asset and liability as reflected in its balance sheet represent significant estimates in the financial statements.	As part of our audit work we have: • Identified the controls put in place by management to ensure that the pension fund liability is not materially misstated. We also assessed whether the controls were implemented as expected and whether they were sufficient to mitigate the risk of material misstatement, • Reviewed the competence, expertise and objectivity of the actuary who carried out the Council's pension fund valuation, • Gained an understanding of the basis on which the IAS 19 valuation was carried out, undertaking procedures to confirm the reasonableness of the actuarial assumptions made, • reviewed the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial report from your actuary, and • gained assurance over the controls over the information provided to the actuary. Our audit work has not identified any issues in respect of the pension fund net liability.

Audit of the accounts – Pension Fund

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

<table>
<tr><th>Risks identified in our audit plan</th><th>How we responded to the risk</th></tr>
<tr><td>The revenue cycle includes fraudulent transactions

Under ISA (UK&I) 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.

This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.</td><td>Having considered the risk factors set out in ISA240 and the nature of the revenue streams at Worcestershire County Council Pension Fund, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because:
• there is little incentive to manipulate revenue recognition
• opportunities to manipulate revenue recognition are very limited; and
• the culture and ethical frameworks of local authorities, including Worcestershire County Council as the administering authority, mean that all forms of fraud are seen as unacceptable.

Our audit work has not identified any material issues in respect of revenue recognition.</td></tr>
<tr><td>Management over-ride of controls

Under ISA (UK&I) 240 it is presumed that the risk of management over-ride of controls is present in all entities.</td><td>As part of our audit work we have:
• reviewed accounting estimates, judgements and decisions made by management,
• tested journal entries
• reviewed unusual significant transactions

Our audit work has not identified any evidence of management over-ride of controls. In particular the findings of our review of journal controls and testing of journal entries has not identified any significant issues.

Our interim audit identified that there had been delays in posting investment journals during the year, however this had all been resolved during the year end processes.</td></tr>
</table>

Audit of the accounts – Pension Fund

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

Risks identified in our audit plan	How we responded to the risk
Level 3 Investments – Valuation is incorrect Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments are those investments which are not actively traded and by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.	As part of audit work we have: • gained an understanding of the transactions via discussions with the pension fund team and reviewed supporting documentation. • carried out walkthrough tests of the controls identified in the cycle. • tested a sample of investments by obtaining and reviewing the audited accounts at latest date for individual investments and agreeing these to the fund manager reports at that date. Reconciliation of those values to the values at 31s March with reference to known movements in the intervening period. • reviewed the qualifications of fund managers as experts to value the level 3 investments at year end and gain an understanding of how the valuation of these investments has been reached. • reviewed the nature and basis of estimated values and considered what assurance management has over the year end valuations provided for these types of investments. • reviewed the competence, expertise and objectivity of any management experts used. This is the first year that the Fund has had level 3 investments, investing just over 8% of the value of the fund in this way. As a result there were some instances where we needed to work with both officers and individual fund managers to ensure we had the appropriate assurances in place over the valuation of these investments. We have no material issues to report in respect of the valuation of level 3 investments. However, we have made some recommendations for improvements to disclosures.

Audit of the accounts

Audit opinion

We gave an unqualified opinion on the Council's accounts on 28 July 2016, in advance of the 30 September 2016 national deadline.

The Council made the accounts available for audit in line with the agreed timetable, and provided a good set of working papers to support them, with improvements in key areas such as property, plant and equipment. There remain areas where further improvements could be made and these have been discussed with officers.

Issues arising from the audit of the accounts

We reported the key issues from our audit of the accounts of the Council to the Council's Audit and Governance Committee on 21 July 2016. The overall volume and significance of the issues raised during the audit decreased from the prior year, with no adjustments identified which affected the Council's reported financial position. The adjustments made to the accounts were made to improve the overall presentation of the financial statements and ensure greater alignment with the Code.

We also reported that the notice of audit initially published by the Council was not in accordance with the new Accounts and Audit Regulations 2015. This situation was resolved during the on site audit visit, and a revised notice was issued on the website to ensure compliance.

Pension fund accounts

We also reported the key issues from our audit of accounts of the Pension Fund hosted by the Council to the Council's Audit and Governance Committee on 21 July 2016. As for the County audit there were no changes made to the financial position of the fund, and a number of improvements had been made to the quality of the working papers to support the financial statements.

We noted that this year was the first year that the fund have invested in level 3 investments, which add an additional level of complexity to the valuation of these assets. As a result of the first time nature of these investments, working papers were less developed, and greater narrative disclosure was required within the accounts to highlight both the level of estimation uncertainty in the accounts as a result of these investments and the critical judgements required.

Annual Governance Statement and Narrative Report

We are also required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website with the draft accounts in line with the national deadlines.

Both documents were prepared in line with the relevant guidance and were consistent with the supporting evidence provided by the Council and with our knowledge of the Council. We commented that there was scope to improve the disclosures within the narrative report and provide a greater level of transparency for the reader of the accounts.

Whole of Government Accounts (WGA)

We carried out work on the Council's consolidation schedule in line with instructions provided by the NAO . We issued a group assurance certificate which did not identify any issues for the group auditor to consider

Other statutory duties

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

We have not had to exercise any of our other statutory duties in relation to the accounts.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice (the Code), following the guidance issued by the NAO in November 2015 which specified the criterion for auditors to evaluate:

In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Key findings

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

The key risks we identified and the work we performed are set out in table 2 overleaf.

As part of our Audit Findings report agreed with the Council in July 2016, we agreed the following recommendation to address our findings.

- As part of reviewing the budget reports and the information presented to members, we have discussed with officers the levels of reserves and balances currently held when compared with other similar local authorities. While we acknowledge the rationale for these balances, there is scope to include greater transparency in the budget reporting.

Overall VfM conclusion

We are satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2016.

Value for Money

Table 2: Value for money risks

Risk identified	Work carried out	Findings and conclusions
The Corporate Plan clearly set out the vision of the authority to become a 'Commissioning Authority'. The Council has progressed well against this vision, with a number of services now provided by others, either through contracts with the private sector, or more recently through the setting up of a local authority trading company.	We have reviewed the Council's current progress against its vision and gained an understanding of the picture of Commissioning across the authority.	The Council currently provides a significant proportion of its services, (just over 75%) through external providers. The services provided in this way are wide ranging , and include residential and nursing provision (£64m), day care and supported living (£44m) and waste management (£39m). Officers and members recognise the importance of good commissioning arrangements and the authority has been restructured to enable the focus in this area to continue. Investment has been made to ensure that the Council has the appropriate skills in place to both negotiate contracts and manage those already in place. During the year, there has been significant activity, including the creation of Place Partnership, a property asset management local authority trading company, the commissioning of Learning and Achievement support services to Babcock international, internal commissioning of children's residential centres and the sale of ICT to Schools to Capita Children's Services. In each case the benefits to both the Council and service users have been carefully considered and reported to members. The Council continues to look at the varied ways that services can be provided and how to achieve the best outcomes for its service users. Given the current budget constraints this area will continue to be key to ensuring the financial sustainability of the Council.

Value for Money

Table 2: Value for money risks continued

Risk identified	Work carried out	Findings and conclusions
The Council identified savings of £23.8m as part of the 2015/16 budget setting, £12.6m of which would come from the Directorate of Adult Services and Health. Like many other County Councils, the draft financial settlement for 2016/17 was worse than expected, and as a result further significant savings will need to be made to balance the budget.	We have reviewed the Council's arrangements for identifying and agreeing savings plans, and communicating key findings to the Council and key decision making committees.	Historically the Council has a strong track record of meeting its financial targets. The outturn position after the transfers to directorate reserves shows a surplus of £0.8m on actual expenditure of £331m. As for the prior year, this year end position continues to mask a significant cost pressure in children's services of £5.7m. This cost pressure has been consistently predicted and reported throughout the year, with detailed reporting explaining how the actions taken have not been able to contain spending within the original budget. The original savings target has been delivered, however £3m of this was met with one off savings rather than those originally planned. These un-met savings have been carried forward and are included within the 2016/17 targets as part of the medium term financial plan. Like many other similar local authorities, the financial outlook remains challenging with the latest medium term financial plan identifying £24.8m of savings to be made in 2016/17, with further savings of £34.1m in 2017/18, £24.1m in 2018/19 and £21.7m needed in 2019/20. For 2016/17 plans are in place for the achievement of the £24.8m, with work well advanced on how savings could be achieved in future years. As part of reviewing the budget reports and the information presented to members, we have discussed with officers the levels of reserves and balances currently held when compared with other similar local authorities. While we acknowledge the rationale for these balances, there is scope to include greater transparency in the budget reporting. While the long term funding of the Council continues to reduce, there are appropriate arrangements in place to balance the budget. Officers and members continue to demonstrate a good understanding of the financial constraints that they are working within, and how these can be managed to produce the best outcome for residents.

Value for Money

Table 2: Value for money risks continued

Risk identified	Work carried out	Findings and conclusions
As at October 2015 the forecast overspend in children's services is projected to be £5.8m. This is due to costs of placing children in external placements. This area of expenditure continues to cause significant financial pressures on the overall budget.	We have reviewed the Council's arrangements for managing the overspend, and the plans in place to ensure that this service is sustainable.	The authority continues to recognise the challenges it faces for looked after children, and while putting in place a number of areas of work around demand management and cost reductions, due to the nature of these projects there is limited evidence of success in the short term. Further budget pressures have been identified in 2016/17 with a further £5m of growth being included in the budget in this area. There is evidence that key parts of the recovery plan are being achieved, however given the nature of the service there remain risks and sensitivities that the plans in place do not deliver the requirement improvements in outcomes and reductions in costs as envisaged over the medium term financial plan. There is clear scrutiny in this area, and arrangements appear appropriate.
The Health economy within Worcestershire continues to face difficulties. How the Council works with Health partners will be key to the achievement of its own strategic objectives.	We have reviewed the Council's arrangements for working with its health partners.	The Corporate plan has four areas of focus, one of these is the Health and Wellbeing of Worcestershire. The plan recognises that key to the achievement of this objective is the need to work in partnership with a wide range of organisations. The county has a number of arrangements in place as to how it works with the health sector and other interested partners. Part of these arrangements include the operation of the Health and Well Being board and the Health overview and scrutiny committee. Progress on the areas of focus within the Corporate Plan is regularly monitored by the Cabinet, with key achievements such as the introduction of 'Your Life Your Choice' and the success of the promoting independence programme being recognised. There is evidence that officers from both the Council and local health bodies work well together, with progress made in a number of areas, particularly in the re-commissioning of services such as integrated recovery. These arrangements will need to continue to develop as funding continues to reduce across the whole of the public sector.

Working with the Council

Our work with you in 2015/16

We are really pleased to have worked with you over the past year. We have established a positive and constructive relationship, and together delivered effectively.

An efficient audit – we delivered the accounts audit at the end of July, two months before the statutory deadline and in line with the timescale we agreed with you. Our audit team are knowledgeable and experienced in your financial accounts and systems. Our relationship with your team provides you with a financial statements audit that continues to finish ahead of schedule releasing your finance team for other important work.

Improved financial processes – we have worked with you during the year and highlighted issues as they have arisen, particularly where these would have impacted on the ability to meet the early opinion deadline set.

Understanding your operational health – through the value for money conclusion we provided you with assurance on your operational effectiveness.

Sharing our insight – we provided regular updates covering best practice. Areas we covered included Innovation in public financial management, Making devolution work, and Reforging local government. We have also shared with you our insights on advanced closure of local authority accounts, in our publication "Transforming the financial reporting of local authority accounts" and will continue to provide you with our insights that are appropriate.

Thought leadership – We have shared with you our publication on Building a successful joint venture and officers attended our seminar held in our Birmingham office in July.

Providing training – we provided your teams with training on financial accounts and annual reporting. We have continued to provide the finance team with regular updates on emerging issues, particularly Highways Network Assets, which will be a key issue for the production of the accounts in 2016/17.

Providing information – We provided you with access to CFO insights, our online analysis tool providing you with access to insight on the financial performance, socio-economy context and service outcomes of councils across the country.

Working with the Council

Working with you in 2016/17
Highways Network Asset

The Code of Practice on Local Authority Accounting (the Code) requires authorities to account for Highways Network Asset (HNA) at depreciated replacement cost (DRC) from 1 April 2016. The Code sets out the key principles but also requires compliance with the requirements of the recently published Code of Practice on the Highways Network Asset (the HNA Code), which defines the assets or components that will comprise the HNA. This includes roads, footways, structures such as bridges, street lighting, street furniture and associated land. These assets should always have been recognised within Infrastructure Assets.

The Code includes transitional arrangements for the change in asset classification and the basis of measurement from depreciated historic cost (DHC) to DRC under which these assets will be separated from other infrastructure assets, which will continue to be measured at DHC.

This is expected to have a significant impact on the Council's 2016/17 accounts, both in values and levels of disclosure, and may require considerable work to establish the opening inventory and condition of the HNA as at 1 April 2016.

Under the current basis of accounting values will only have been recorded against individual assets or components acquired after the inception of capital accounting for infrastructure assets by local authorities. Authorities may therefore have to develop new accounting records to support the change in classification and valuation of the HNA.

The nature of these changes means that Finance officers will need to work closely with colleagues in the highways department and potentially also to engage other specialists to support this work.

Some of the calculations are likely to be complex and will involve the use of external models, a combination of national and locally generated rates and a number of significant estimates and assumptions.

We have been working with the Council on the accounting, financial reporting and audit assurance implications arising from these changes. We have issued two Client Briefings which we have shared with key accounting staff. We will issue further briefings during the coming year to update the Council on key developments and emerging issues.

This significant accounting development is likely to be a significant risk for our 2016/17 audit, so we have already had some preliminary discussions with the Council to assess the progress it is making in this respect. Our discussions with Council Officers to date has highlighted that the finance team have a plan in place and this is supported by the finance team and also the team from highways.

We will continue to liaise closely with the senior finance team during 2016/17 on this important accounting development, with timely feedback on any emerging issues.

The audit risks associated with this new development and the work we plan to carry out to address them will be reflected in our 2016/17 audit plan.

We will also continue to work with you and support you over the next financial year in other areas, in particular the change of financial system.

Appendix A: Reports issued and fees

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

Fees

	Planned £	Actual fees £	2014/15 fees £
Statutory audit of Council	95,446	95,446	136,171
Statutory audit of Pension Fund	24,963	24,963	24,963
Agreed fee variation on Pension Fund for IAS 19 required work for admitted bodies	1,193	1,193	1,193
Total fees (excluding VAT)	**121,601**	**121,601**	**162,327**

Fees for other services

Service	Fees £
Audit related services:	
• Gypsy and Traveller grant	**£3,000**
• Major Transport grant	**£3,500**
• SFA compliance work	**£4,000**
Non-audit services	**£0**

Reports issued

Report	Date issued
Audit Plan	March 2016
Audit Findings Report	July 2016
Annual Audit Letter	October 2016

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