Suffolk County Council

Annual Audit Letter for the year ended 31 March 2015

October 2015

Ernst & Young LLP

Building a better working world

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14 October 2015

Dear Members

Annual Audit Letter 2014-15

The purpose of this annual audit letter is to communicate the key issues arising from our work to the Members and external stakeholders, including members of the public.

We have already reported the detailed findings from our audit work in our 2014-15 annual results report to the 24 September 2015 Pensions Committee and the 25 September 2015 Audit Committee, representing those charged with governance. We do not repeat them here.

The matters reported here are those we consider most significant for the Council.

We would like to take this opportunity to thank officers for their assistance during the course of our work.

Yours faithfully

Neil Harris
Director
For and on behalf of Ernst & Young LLP
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Contents

1. Executive summary

Our 2014-15 audit work was undertaken in accordance with the Audit Plan issued on 21 July 2015 and was conducted in accordance with the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission.

The Council is responsible for preparing and publishing its Statement of Accounts, accompanied by an Annual Governance Statement (AGS). In the AGS the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for having proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

As auditors we are responsible for:

- forming an opinion on the financial statements, including the Pension Fund, and on the consistency of other information published with them
- reviewing and reporting by exception on the Council's AGS
- forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources
- undertaking any other work specified by the Audit Commission and the Code of Audit Practice.

Summarised below are the results of our work across all these areas:

Area of work	Result
Audit of the financial statement of Suffolk County Council and Suffolk Pension Fund for the financial year ended 31 March 2015 in accordance with International Standards on Auditing (UK & Ireland)	On 29 September 2015 we issued an unqualified audit opinion on the Council's financial statements On 29 September 2015 we issued an unqualified audit opinion on Suffolk Pension Fund
Form a conclusion on the arrangements the Council has made for securing economy, efficiency and effectiveness in its use of resources	On 29 September 2015 we issued an unqualified value for money conclusion
Report to the National Audit Office on the accuracy of the consolidation pack the Council needs to prepare for the Whole of Government Accounts	We reported our findings to the National Audit Office on 29 September 2015
Consider the completeness of disclosures on the Council's AGS, identify any inconsistencies with other information which we know about from our work and consider whether it complies with CIPFA/ SOLACE guidance	No issues to report
Consider whether we should make a report in the public interest on any matter coming to our notice in the course of the audit	No issues to report
Determine whether we need to take any other action in relation to our responsibilities under the Audit Commission Act	No issues to report

As a result of the above we have also:	
Issued a report to those charged with governance of the Council with the significant findings from our audit.	Our Audit Results Report was issued on 25 September 2015 to the Audit Committee
Issued a certificate that we have completed the audit in accordance with the requirements of the Audit Commission Act 1998 and the Code of Practice issued by the Audit Commission.	Issued on 29 September 2015

2. Key findings

2.1 Financial statement audit

The Council's Statement of Accounts is an important tool to show both how the Council has used public money and how it can demonstrate its financial management and financial health.

We audited the Council's Statement of Accounts in line with the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission and issued an unqualified audit report on 29 September 2015.

Our detailed findings were reported to the 25 September 2015 Audit Committee.

The quality of the Council's working papers and quick resolution of our audit queries has again facilitated our audit.

Financial statements

The Council's energy from waste plant PFI in Great Blakenham became operational in December 2014. In the 2014-15 financial year, the Council recognised the waste plant PFI in the financial statements for the first time, valued at £180 million. Whilst there are PFIs elsewhere in the public sector, there is little precedent for the accounting and valuation of waste plant PFIs. This was a time consuming exercise for the Council's finance team, involving complex estimation techniques and represented a significant audit risk. Both the Council and us as auditors commissioned and considered representations from our respective experts on the appropriate accounting and valuation of the waste PFI site. This was the most significant accounting judgement for the Council in the 2014-15 financial year, and required significant audit time. The Council took the accounting and valuation of the waste plant facility seriously and engaged experts throughout. Inevitably, there are learning points arising from this process regarding the approach to accounting for and valuing such specialised assets. We discussed some improvements the Council could make to strengthen its internal controls in this area. The Council amended the financial statements for adjustments made to the PFI accounting model as detailed in the table below.

Following the material amendments relating to the PFI, we issued an unqualified audit opinion. In addition to the PFI, there were other accounting judgements that the Council had to consider, including schools accounting, recognition of third party monies, valuation of its asset base and assessment of its group boundary. Except for the PFI accounting, the limited matters arising confirmed that the Council continued to prepare its financial statements and work papers to a high standard.

The main issues identified as part of our audit were:

Significant risk 1: Risk of management override of controls

As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.

We have identified no findings that would indicate there is a risk of material misstatement due to fraud or error.

Significant risk 2: PFI waste plant

The Council has a PFI contract with SITA Suffolk Ltd to build and operate an energy plant from a waste facility at Great Blakenham. The plant was completed and became operational in December 2014. The Code requires that the PFI asset, the related PFI liability, and income and expenditure arising from the contract are recognised in the Council's accounts from the date the asset becomes operational and service provision commences in accordance with IFRIC 12. There is therefore a risk that the transactions and balances relating to the PFI contract may be incorrectly accounted for, accounted for from the incorrect date or omitted from the accounts.

Valuation

We identified one judgemental misstatement relating to the valuation of the PFI energy from waste plant, which management amended in the financial statements. Following detailed analysis by our Estates experts of the Council's basis and data used to arrive at the £180 million valuation of the waste PFI plant, we concluded that the Council had not appropriately applied indexation to the period when the cost of the plant was fixed in 2011 and the 31 March 2015 valuation date. In our view, the waste PFI plant could reasonably have resulted in an additional uplift of 5.7%, reflecting our interpretation of the likely movements in prices since 2011. This would mean that the waste PFI plant could be undervalued by at least £10.2 million. This figure has some judgemental and estimation uncertainty as the Council is not yet in a position of confirming the actual incurred cost and would need to revisit this when known and conduct an impairment review. Therefore, the valuation of the waste PFI plant could reasonably be expected to have some future upsides (indexation) and downsides (impairment review). The Council amended the financial statements for the £10.2 million judgemental misstatement. We concluded, following this adjustment, that the valuation of the waste PFI plant at 31 March 2015 was within a reasonable range of error and uncertainty.

Accounting model

The Council used an accounting model to produce the entries relating to PFI in the financial statements. Our audit identified misstatements relating to the PFI accounting model. Work was required on the model to revise a number of entries in the financial statements to reflect the nature of the transactions relating to the PFI. The waste PFI operator funds the asset underlying the project from a mix of payments from the Council. Part of the payments do not depend on how much waste is treated, further payments do depend on how much waste is treated, and other payments represent revenue from parties other than the Council. This means that while the Council recognises all of the assets on the balance sheet, it recognises a liability to pay for some of those assets and the remainder, which the operator funds from third party revenues, are donated assets. The draft accounts required material adjustments to reduce the long term liability balance, some service costs and the financial liability interest relating to the PFI.

Significant risk 3: Accounting for schools

Accounting for schools has been a key issue over previous years. This has focused on the accounting treatment of assets held by locally maintained schools and whether these assets are controlled by the local authority and therefore on the Council's balance sheet. This control assessment has focused on the five main categories of schools, community, voluntary controlled, voluntary aided, foundations and academies. During 2014-15, guidance has been issued in this area, specifically an update to the Code and LAAP Bulletin 101; Accounting for Non-Current Assets Used by Local Authority Maintained Schools. The updated guidance considers further the impact of ownership on the control assessment; specifically the fact that voluntary controlled, voluntary aided and a number of foundation schools may be owned by religious bodies.

We have identified no findings that would indicate there is a risk of material misstatement.

2.2 Value for money conclusion

As part of our work we must also conclude whether the Council has proper arrangements to secure economy, efficiency and effectiveness in the use of resources. This is known as our value for money conclusion.

In accordance with guidance issued by the Audit Commission, our 2014-15 value for money conclusion was based on two criteria. We consider whether the Council had proper arrangements in place for:

- securing financial resilience, and
- challenging how it secures economy, efficiency and effectiveness.

We issued an unqualified value for money conclusion on 29 September 2015.

Our audit did not identify any significant matters.

2.3 Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Authority for Whole of Government Accounts purposes. We had no issues to report.

2.4 Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's AGS, identify any inconsistencies with the other information which we know about from our work, and consider whether it complies with relevant guidance.

We completed this work and did not identify any areas of concern.

2.5 Objections received

We did not receive any objections to the 2014-15 financial statements from members of the public.

2.6 Other powers and duties

We identified no issues during our audit that required us to use powers under the Audit Commission Act 1998, including reporting in the public interest.

2.7 Independence

We communicated our assessment of independence to the Audit Committee on 29 September 2015. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements

3. Control themes and observations

As part of our work, we obtained enough understanding of internal control to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we must tell the Council about any significant deficiencies in internal control we find during our audit.

The matters reported are shown below. We have listed only the deficiencies we found during the audit which we think it is important to bring to your attention.

Description	Impact
Our work on the PFI incurred more time than originally planned due to revisions required to the work of the Council's experts as detailed in section 2.1 of this letter. The valuation of the PFI plant required significantly more detail to support the basis and methodology of the valuation and the accounting model producing the entries relating to the PFI in the financial statements also required amendments. Officers sought to address the complexity of the PFI transaction through engaging experts.	We have discussed improvements to the procedures used by the Council in determining the selection of experts to support work on complex transactions with officers, including the assessment of the prior experience of the expert in undertaking similar work to obtain sufficient assurance on the scope of the experts' work and approach.

4. Looking ahead

Description	Impact
Highways Network Assets (formerly Transport Infrastructure Assets) The Invitation to Comment on the Code of Accounting Practice for 2016-17 (ITC) sets out the requirements to account for Highways Network Asset under Depreciated Replacement Cost from the existing Depreciated Historic Cost. This is to be effective from 1 April 2016. This will be a material change of accounting policy for the Council. It will also require changes to existing asset management systems and valuation procedures. Relevant assets may also be held outside of the highways department, for example, within the Housing Revenue Account, which will also have to be valued on the revised basis. Nationally, latest estimates are that this will add £1,100 billion to the net worth of authorities.	CIPFA have produced LAAP bulletin 100, which provides a suggested timetable for actions to prepare for this change. This has been supplemented by the issue of the Code of Practice on Transport Infrastructure Guidance Notes (May 2015) and ITC (July 2015). The Council should consider the following in their preparation for this requirement. • The need to demonstrate completeness of base information, working closely with highways and other relevant departments. • The need to ensure that valuation information is appropriate to the Council, and that national valuation indicators are not used without consideration of their appropriateness locally.
Devolution proposal The Council's devolution proposal was based on the Expression of Interest submitted to Government on 4 September 2015. This was developed by the Council and public sector partners, in response to the Government's invitation as part of the Spending Review to submit fiscally-neutral proposals for devolved arrangements to the Treasury. The invitation builds on Government commitment to enhance local autonomy through devolution, reflected in the Cities and Local Government Devolution Bill currently before Parliament. The Council, with other Suffolk leaders, has worked to develop a shared ambition for devolution to serve as the basis for negotiation with the government for a robust deal to deliver better outcomes for local people. Suffolk and Norfolk councils are currently working on joint proposals to be submitted to central government.	Budget monitoring currently forecasts that the revenue budget will be overspent by £2.9 million, equivalent to 0.6% of the net budget. The major risk in managing the budget in 2015-16 is the requirement to achieve £38.3 million of savings in the year whilst minimising the impact on front line services. In addition the cost and demand for purchased care placements for adults and children continue to put pressure on the Council's budget. The Council should ensure that detailed work to submit revised devolution proposals, and any subsequent work required, does not detract from the Council's role in ensuring strong financial management to address the budget gap over the medium term. The need to achieve challenging financial savings targets will include assessment of savings arising from transforming the way that services are currently delivered.
Better Care Fund The Better Care Fund (BCF) is a major policy initiative between local authorities, clinical commissioning groups (CCGs) and NHS providers with a primary aim of driving closer integration and improving outcomes for patients, service users and carers. From 1	Local BCF arrangements may be complex and varied, involving a number of different commissioning, governance and accounting arrangements that raise risks of misunderstanding, inconsistencies and confusion between the partners. There are also structural, cultural and regulatory

Description	Impact
April 2015 BCF has been set up as a pooled budget between local government and NHS partners using powers available under pre-existing legislation. The partners use the pooled fund to jointly commission or deliver health and social care services at a local level. Although local authorities, CCGs and NHS providers have experience of pooled budgets and established joint commissioning arrangements, pooled arrangements under BCF are likely to be on a much larger scale. Nationally the fund is comprised of a number of existing funding streams and will involve a minimum NHS spend of £3.8 billion together with other grant funding streams historically administered by local authorities. The detailed form of local pooled arrangements is not prescribed and has needed to be agreed between the partners.	differences between local government and the NHS, and it is important that these are understood and considered by all of the partners in the operation of the pool. In October 2014 HFMA/CIPFA produced "Pooled Budgets and the Better Care Fund" which provides more detailed guidance on the governance and finance issues underpinning the operation of a pooled budget and the associated risks and challenges faced by local government and NHS partners and we have held initial discussions with officers in this respect. The Council has an agreement in place and this was signed by 1 April 2015. The Council is the host body for the BCF. The Council has a savings requirement of £4.1 million to be delivered through a transfer under the Better Care Fund from the three CCGs in Suffolk. This is to be achieved by a combination of savings measures put in place by the CCGs, a reduction in hospital admissions for non-elective (emergency) care, and a guaranteed funding transfer agreed with one of the CCGs. At this stage, only £1.5 million of the £4.1 million is expected to be transferred to the Council in 2015/16, resulting in a budget shortfall of £2.6 million. The Council continues to engage with the CCGs to improve on this position however the challenging financial position faced by the health sector represents a risk to achieving a successful outcome.
The Accounts and Audit Regulations 2015 were laid before Parliament in February 2015. A key change in the regulations is that from the 2017-18 financial year the timetable for the preparation and approval of accounts will be brought forward. As a result, the Council will need to produce draft accounts by 31 May and these accounts will need to be audited by 31 July.	These changes provide challenges for both the preparers and the auditors of the financial statements. The Council is aware of this challenge and the need to start planning for the impact of these changes. This will necessarily include review of the processes for the production and audit of the accounts, including areas such as the production of estimates, particularly in relation to pensions and the valuation of assets, and the year-end closure processes. The Council has made good progress towards earlier closedown and the majority of our audit, excluding the PFI transactions, was complete by 31 July 2015. Based upon this, the Council is prepared for the 2017-18 deadlines.

5. Fees

Our fee for 2014-15 is greater than the scale fee set by the Audit Commission and reported in our Audit Plan.

	Estimated final fee 2014-15	Planned fee 2014-15	Scale fee 2014-15	Final fee 2013-14
Total Audit Fee – Code work *	TBC	£133,690	£120,690	£120,690
Total Audit Fee –Certification of claims and returns **	-	-	-	£5,865
Non-audit work ***	TBC	£40,250	-	£14,750

* The planned audit fee for 2014-15 included the £120,690 scale fee published by the Audit Commission and an estimated scale fee variation of £13,000 to cover our additional work on the PFI waste plant included in the 2014-15 accounts. Our Annual Results Report issued to the Audit Committee on 25 September noted that our actual fee is likely to exceed the proposed fee of £133,690 due to additional work required in respect of the PFI plant. We will confirm our final audit fee for code work, including the additional fee for our work on the PFI plant, separately. Any variation to our audit fee is subject to agreement with the Council's Audit Committee and PSAA (the successor body to the Audit Commission).

** No claims are due to be certified for 2014-15 under the certification regime.

*** We have undertaken non-audit work outside of the former Audit Commission's Audit Code requirements on PFI refinancing work as detailed in our audit plan, in the sum of £20,000. Further non-audit work is proposed in respect of certification of claims and returns falling outside the certification regime. This work is to be confirmed. The estimated fees for this work are in the region of £20,000 - £25,000.