

The Annual Audit Letter for Cumbria County Council

Year ended 31 March 2016

October 2016

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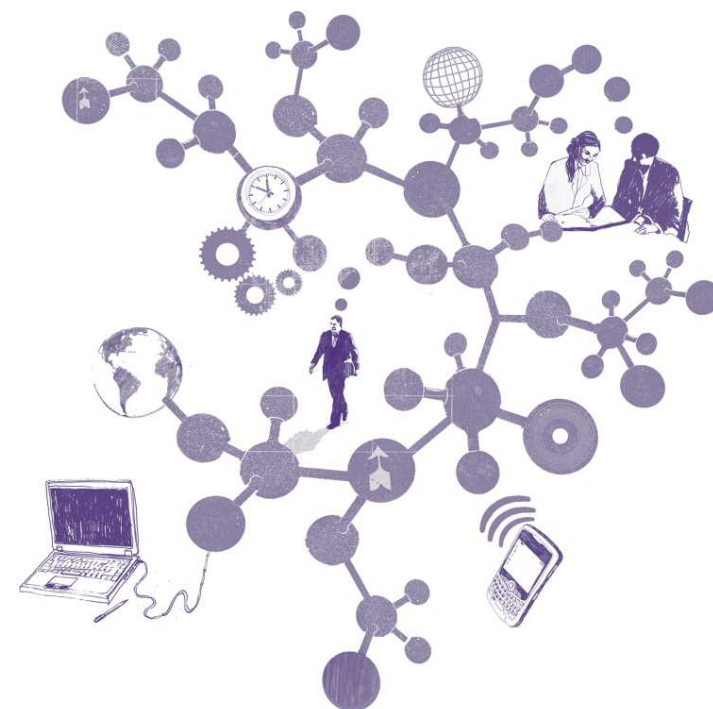
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Executive summary

Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Cumbria 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 Assurance Committee as those charged with governance in our Audit Findings Report on 21 September 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's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council'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 the Council's financial statements on 30 September 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 except for the on-going impact of the "inadequate" Children Services Ofsted regulator inspections as reported in May 2012, June 2013 and May 2015. We therefore issued a qualified 'except for' value for money conclusion in our audit opinion on 30 September 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 30 September 2016.

Certificate

We certified that we had completed the audit of the accounts of Cumbria County Council in accordance with the requirements of the Code on 30 September 2016.

Working with the Council

We are really pleased to have worked with you over the past year. We have established a positive and constructive relationship. Together we have delivered some great outcomes.

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

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 £15,824,000, which is 1.75% 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 related party transactions, senior officer remuneration, salary bandings and exit packages, and disclosure of auditor's remuneration within the financial statements.

We set a lower threshold of £740,000, above which we reported errors to the Audit and Assurance Committee in our Audit Findings Report.

Pension Scheme

For the audit of the Cumbria Pension Scheme accounts, we determined materiality to be £19,736,000, which is 1% of the Scheme's net assets. We used this benchmark, as in our view, users of the Pension Scheme 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 £986,000 above which we reported errors to the Audit and Assurance 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.

Table 1: Key financial statements risks - Council

Risks identified in our audit plan	How we responded to the risk
<p>Valuation of pension fund net liability</p> <p>The Council's pension fund assets and liabilities as reflected in the County Council's balance sheet represent significant estimates in the financial statements and comprises 46% of its total liabilities. The values of the pension fund net liability is estimated by specialist actuaries.</p> <p>In 2015/16, in response to the move to earlier close-down, there is a greater degree of estimation in the information provided to the actuary.</p>	<p>The work we performed on this risk included:</p> <ul style="list-style-type: none">• documented the key controls that were put in place by management to ensure that the pension fund liability was not materially misstated;• walkthrough the key controls to assess whether they were implemented as expected in order to mitigate the risk of material misstatement in the financial statements;• 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; and• reviewed the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial report from the Council's actuary. <p>Our audit work has not identified any issues in respect of the valuation of the pension fund net liability.</p>

Audit of the accounts – Council

Risks identified in our audit plan	How we responded to the risk
<p>Valuation of property, plant and equipment</p> <p>Property Plant and Equipment represents 24% of the Council's assets. Their value is estimated by property valuation experts. The Council revalues its assets on a rolling basis over a five year period.</p> <p>For 2015/16 new accounting standards on fair value (IFRS 13) were introduced. There are also adaptations to IAS 16 on property, plant and equipment that apply in 2015/16, including additional disclosure requirements.</p> <p>Cumbria experienced severe flooding in several areas during December 2015 impacting on a number of Council services, buildings and infrastructure.</p>	<p>The work we performed on this risk included:</p> <ul style="list-style-type: none">• reviewed management's processes and assumptions for the calculation of the estimate, new accounting standards and impact of flooding;• gained an understanding of management's processes to account for the impact on asset valuations due to the flooding;• reviewed the competence, expertise and objectivity of any management experts used and review of the instructions issued to valuation experts and the scope of their work;• discussed with the Council's valuer about the basis on which the valuation was carried out, challenging the key assumptions and review and challenge of 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. <p>Our audit work has not identified any issues in respect of the valuation of property, plant and equipment.</p>

Audit of the accounts – Pension Scheme

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 scheme.

Table 2: Key financial statements risks – Pension Scheme

Risks identified in our audit plan	How we responded to the risk
<p>Level 3 Investments – Valuation is incorrect</p> <p>Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Pension fund investments are classified into 3 levels depending on the availability of readily available information to assess their value. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.</p>	<p>The work we performed on this risk included:</p> <ul style="list-style-type: none">• gained an understanding of the transaction including a review of 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 the latest date for individual investments and agreeing these to the fund manager reports at that date. Reconciliation of those values to the values at 31 March 2016 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; and• reviewed the competence, expertise and objectivity of any management experts used. <p>Our audit work identified an understatement of £3.751 million in respect of the valuation of 3 investment manager portfolios that impact upon level 3 investments and management did not adjust. The decision to not adjust was due to immateriality and did not impact upon the audit opinion as the total valuation of investment assets in the net assets statement were £2.034 billion.</p>

Audit of the accounts

Audit opinion

We gave an unqualified opinion on the Council's accounts on 30 September 2016. 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. The finance team responded promptly and efficiently to our queries during the course of the audit.

Council accounts

We reported the key issues from our audit of the accounts of the Council to the Council's Audit and Assurance Committee on 21 September 2016.

In the primary statements we identified one misstatement to the group balance sheet, but this was a classification error only and did not impact upon the net reserves position as £1 million was moved from short-term investments to cash and cash equivalents.

In addition, four minor disclosure note adjustments were noted and adjusted.

From our work on treasury management we identified that there was a different limit for investment in money market funds between the strategy approved by the Council (£15million) and that used by the finance team of £20 million. Officers confirmed the £15 million in the strategy was a typographical error. Any breach did not result in any financial loss or increased risk, and only occurred during 2015/16 as the 2016/17 policy reflects the intended £20 million values.

We made one recommendation with regard to internal control, which management agreed. This was to introduce additional controls to agree the approved treasury management strategy to investment decisions on a regular basis.

Pension scheme accounts

We also reported the key issues from our audit of accounts of the Pension Scheme hosted by the Council to the Council's Audit and Assurance Committee on 21 September 2016.

We identified an misstatement of £3.751 million in the valuation of investments which management did not amend as they considered it not to be material. The decision to not adjust did not impact upon the audit opinion, as the total valuation of investment assets in the net assets statement is £2.034 billion. The issue arose as more up to date information was available before the accounts were authorised for issue.

As a result, we made a recommendation which management agreed to review the most up to date information for investment managers prior to the authorised for issue date and a minor issue regarding disclosure within the Annual Report.

One minor adjustment was also identified to enhance presentation within a disclosure note which management amended.

Our work on the Annual Report resulted in a minor recommendation regarding the Annual Report in terms of consideration of further disclosure of financial indicators. Management have agreed to consider this further disclosure.

Audit of the accounts

Annual Governance Statement and Narrative Statement

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

The Annual Governance Statement was prepared in line with the relevant guidance and was consistent with the supporting evidence provided by the Council and with our knowledge of the Council.

The Narrative Statement was a new requirement for 2015/16. Some adjustments were identified, but they were minor to improve presentation. We made one recommendation which management agreed to review the scope of the non-financial performance information.

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 did not use our other statutory duties.

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 3 overleaf.

Overall VfM conclusion

We are satisfied that, in all significant respects, except for the matter we identified below, the Council had proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2016.

The 'except for' qualification to the VfM conclusion was in relation to the arrangements the Council had in place for looked after children during the period due to the impact of the "inadequate" Children Services Ofsted regulator inspections as reported in May 2012, June 2013 and May 2015.

We therefore issued a qualified 'except for' value for money conclusion in our audit opinion on 30 September 2016.

Value for Money

Table 3: Value for money risks

Risk identified	Work carried out	Findings and conclusions
<p>Ofsted inspection of children's services</p> <p>Ofsted issued a report on the Council's children's services in May 2015 which rated these as 'inadequate'. This was the third successive assessment of the Council as inadequate following reported assessments in May 2013 and May 2012.</p> <p>Until such time as Ofsted has confirmed that adequate arrangements are in place, this remains a significant risk to the Council's arrangements for looked after children.</p>	<p>We reviewed the Council's project management, performance monitoring arrangements and risk assurance frameworks to monitor progress against the agreed implementation plan.</p>	<p>The Council had a re-inspection in March 2015 on both child protection and looked after children. In summary, Ofsted's overall judgement is that children's services are inadequate. Child protection had improved and was assessed as requires improvement. Some elements of adoption and care leavers assessments were assessed as requires improvement but looked after children and achieving permanence and related leadership, management and governance was scored as inadequate at that time. The report was positive on a number of fronts including; in terms of stronger leadership now in place, significant progress being made on collaborative agency working and direct work with children is of good quality.</p> <p>We acknowledge that Children Services is working hard to deliver the improvement plan, with recruitment and retention of staff as key challenges. Recruitment of 20 posts during the year through the social worker academy project has filled some key staffing shortages, particularly in the south and west of Cumbria. The Ofsted letter of 21 July 2016 summarises the findings of 10 monitoring visits to Cumbria between July 2015 and June 2016 and indicates a positive direction of travel.</p> <p>We concluded there were weaknesses in the Council's arrangements and we issued an 'except for' qualified value for money conclusion in this area.</p>

Value for Money

Risk identified	Work carried out	Findings and conclusions
<p>Health & Social Care Integration</p> <p>The Council is seeking to deliver wide ranging changes and greater integration to ensure the financial sustainability of adult health and social care services. Working with partners from different organisations and service areas with potentially conflicting priorities, the project is complex and high profile.</p>	<p>We reviewed the project management and risk assurance frameworks established by the Council to establish how it is identifying, managing and monitoring these integration related risks.</p>	<p>Health and care services within Cumbria are subject to significant transformation programmes. North Cumbria Hospitals Acute Hospitals NHS Trust is part of the 'Success Regime' project which covers west, north and east Cumbria. University Hospitals of Morecambe Bay NHS Foundation Trust is a key partner in the Vanguard programme 'Better Care Together' covering areas including south Cumbria. In addition a Cumbria Strategy for Mental Health is a whole economy programme to deliver the best quality and sustainable mental health care. The intention of all programmes is to address issues of cost and quality of health and care services.</p> <p>Integration is key to all agendas and Cumbria County Council are fully engaged, with director participation on all schemes. Key focus for all is the delivery of the integration agenda, identifying, and designing work streams, and appropriate governance structures.</p> <p>The Health and Wellbeing Board set the overall joint health and wellbeing strategy for Cumbria. County wide structures are in place with Cumbria County Council and other key partners as part of the Joint Commissioning Board. This is a working-sub group of the Health and Wellbeing Board.</p> <p>The Council has recently conducted an internal review of integration to map and understand attendance and purpose, as this agenda is moving at significant pace and there are challenging timescales.</p> <p>We concluded that the risk was sufficiently mitigated and that the Council had proper arrangements in this emerging, complex and diverse area.</p>

Value for Money

Table 3: Value for money risks

Risk identified	Work carried out	Findings and conclusions
<p>Significant capital projects and service transformation projects</p> <p>The Council's Medium Term Financial Plan (MTFP) is predicated on delivering changes to the way in which services are delivered. The Council has identified proposals for reducing spending and increasing efficiency. The programme includes a number of key projects, including internally reshaping the Council. This is significant both in scale and financial terms.</p>	<p>We reviewed the arrangements the Council has in place to compile the MTFP. This includes a review of how the Council is identifying, managing and monitoring financial information in order to regularly update the MTFP including reporting outcomes to Cabinet and Full Council.</p>	<p>The Council continues to face significant financial challenges. The budget gap in the MTFP was updated in February 2016 for the 3 year period 2016/17 to 2018/19 with savings required over the 3 years of £75 million. The £45 million of savings required for 2016/17 are fully identified, and the Council is confident that it will bridge the £30m budget gap for 2017/18 to 2018/19.</p> <p>The Council has a comprehensive approach to its medium term financial planning, budgeting and identification of saving plans, which are agreed at a corporate level, by senior officers and Members. For the four year period 2011/12 to 2015/16 the Council has identified £153 million of savings and has a strong history of achieving savings. The Council is faced with the continuing challenge of finding further savings which will become increasingly difficult. It will be essential therefore to ensure that its savings plans continue to be clearly communicated, link to specific policy decisions, service reviews and planned rationalisation of the workforce and that the impact on service levels and quality is clearly identified and monitored.</p> <p>The strategy is aligned to the Council's corporate priorities, highlights the key financial risks, and adopts a prudent approach to funding streams. The Council has taken this approach to allow it to have the flexibility and resilience in order to address the variable nature of future funding. The Council has good planning assumptions built into the annual and three year budget processes. The Council is responsive to changes required as the strategic planning process considers optimistic, planned and pessimistic sensitivity analysis.</p> <p>We concluded that the risk was sufficiently mitigated and that the Council had proper arrangements in this area.</p>

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. Together we have delivered some great outcomes.

An efficient audit – we delivered the substantial testing of the accounts audit within a 6 weeks schedule, and 4 weeks before the national 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.

Sharing our insight and Thought leadership – we provided regular external Audit and Assurance Committee updates covering best practice. Areas we covered included; Innovation in public financial management, Knowing the Ropes – Audit Committee; Effectiveness Review, Making devolution work, Reforging local government, Your generation: making decentralisation happen, and Building a successful joint venture company. 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 as you bring forward your production of your year-end accounts.

Providing training – we provided access to your teams with workshop training on financial accounts.

Providing information – We provided you with demonstration access to Place Analytics, 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.

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

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 early with the Council on the accounting, financial reporting and audit assurance implications arising from these changes. We will share knowledge and understanding 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.

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.

Appendix A: Reports issued and fees

We confirm below our final fees charged for the audit and fees for other services.

Fees

	Planned £	Actual fees £	2014/15 fees £
Statutory audit of Council	114,615	114,615	152,820
Statutory audit of Pension Scheme	24,620	24,620	24,620
Total fees (excluding VAT)	139,235	139,235	177,440

Reports issued

Report	Date issued
Audit Plan	21 March 2016
Audit Findings Report	21 September 2016
Annual Audit Letter	26 October 2016

Fees for other services

Service	Fees £
Audit related services: <ul style="list-style-type: none">Grant Certification – Teachers' Pension return	4,900



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