The Annual Audit Letter for Devon County Council

Year ended 31 March 2019

29 August 2019

Contents

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Executive Summary

Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Devon County Council (the Council) for the year ended 31 March 2019.

This Letter is intended to provide a commentary on the results of our work to the Council and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Council's Audit Committee as those charged with governance in our Audit Findings Report on 29 July 2019.

Respective responsibilities

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

- give an opinion on the Council'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) (ISAs) and other guidance issued by the NAO.

Our work

Materiality	We determined materiality for the audit of the Council’s financial statements to be £23.8m, which is 1.9% of the Council’s gross expenditure for the prior year. We used this at the planning stage and the year on year consistency of the Council’s expenditure meant that this continued to be relevant.
Financial Statements opinion	We gave an unqualified opinion on the Council's financial statements on 30 July 2019.
Whole of Government Accounts (WGA)	We completed work on the Council’s consolidation return following guidance issued by the National Audit office (NAO) and made the necessary submission to the NAO on 29 August 2019.
Use of statutory powers	We did not identify any matters which required us to exercise our additional statutory powers.

Executive Summary

Value for Money arrangements	We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Council on 30 July 2019.
Certification of Grants and returns	We also carry out work to certify the Council's Teachers' Pensions return. Our work on this return is not yet complete and will be finalised by 30 November 2019. We will report the results of this work to the Audit Committee separately.
Certificate	We certified that we have completed the audit of the financial statements of Devon County Council in accordance with the requirements of the Code of Audit Practice on 29 August 2019 after the completion of our work on the Council's Whole of Government Accounts consolidation return.

Audit of the Financial Statements

Our audit approach

Materiality

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

We determined materiality for the audit of the Council's financial statements to be £23.8m, which is 1.9**%** of the Council's gross revenue expenditure. We used this benchmark as, in our view, users of the Council's financial statements are most interested in where the Council has spent its revenue in the year.

We set a lower threshold of £1.2m, above which we reported errors to the Audit Committee in our Audit Findings Report.

The scope of our audit

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

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

We also read the remainder of the financial statements and the narrative report and annual governance statement to check it is consistent with our understanding of the Council.

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

Our audit approach 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 Financial Statements

Significant Audit Risks

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
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.	Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Authority, when producing our audit plan we determined that the risk of fraud arising from revenue recognition could 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 Devon County Council, mean that all forms of fraud are seen as unacceptable.	We did not consider this to be a significant risk for Devon County Council. We reviewed this assessment during the course of audit and no new information has come to light to change our original assessment.
Management over-ride of controls Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. . We 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.	As part of our audit work we: • 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 made by management and consider their reasonableness with regard to corroborative evidence; and • evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.	Our audit work did not identify any issues in respect of the management override of controls.

Audit of the Financial Statements

Significant Audit Risks - continued

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Valuation of land and buildings The Authority revalues its land and buildings on a rolling five-yearly basis. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved (£1.4 billion at 31 March 2018) and the sensitivity of this estimate to changes in key assumptions. Additionally, management will need to ensure the carrying value in the Authority's financial statements is not materially different from the current value or the fair value (for surplus assets) at the financial statements date.	As part of our audit work we: • 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; • wrote to 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 Authority's asset register and correctly reflected in the financial statements; • met with the valuer and reviewed a sample of revaluations in detail; and • 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.	Our audit work did not identify any issues in respect of valuation of land and buildings.

Audit of the Financial Statements

Significant Audit Risks - continued

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Valuation of pension fund net liability The Authority's pension fund net liability, as reflected in its balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements. The pension fund net liability is considered a significant estimate due to the size of the numbers involved (£1.1 billion in the Authority's balance sheet at 31 March 2018) and the sensitivity of the estimate to changes in key assumptions.	As part of our audit work 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 evaluated the design of the associated controls; • evaluated the instructions issued by management to its 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; • undertook 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 assurance from the auditors of the Devon 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 did not identify any issues in respect of valuation of the pension fund net liability.

Audit of the Financial Statements

Pension Fund Significant Audit Risks

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Improper revenue recognition 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.	Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Fund, in our audit plan we stated that the risk of fraud arising from revenue recognition could be rebutted, because: • there was little incentive to manipulate revenue recognition; • opportunities to manipulate revenue recognition were very limited; and • the culture and ethical frameworks of local authorities, including Devon County Council and Devon Pension Fund, mean that all forms of fraud are seen as unacceptable.	We did not consider this to be a significant risk for Devon Pension Fund at the planning stage. Our audit work confirmed this assessment.
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 Pension Fund faces external scrutiny of its spending and stewardship of funds and this could potentially place management under undue pressure in terms of how they report performance. 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.	As part of our audit work we: • evaluated the design effectiveness of management controls over journals • analysed the journals listing and determined 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 made by management and considered their reasonableness with regard to corroborative evidence • evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.	Our audit work did not identify any issues in respect of management override of controls.

Audit of the Financial Statements

Pension Fund Significant Audit Risks

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Valuation of Level 3 investments The Fund revalues its investments on an annual basis to ensure that the carrying value is not materially different from the fair value at the financial statements date. By their nature Level 3 investment valuations lack observable inputs. These valuations therefore represent a significant estimate by management in the financial statements due to the size of the numbers involved (c£100m at 31 March 2018) and the sensitivity of this estimate to changes in key assumptions. Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end. Management utilise the services of investment managers as valuation experts to estimate the fair value as at 31 March 2019. We therefore identified valuation of Level 3 investments as a significant risk, which was one of the most significant assessed risks of material misstatement.	As part of our audit work we: • evaluated management's processes for valuing Level 3 investments • reviewed the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments to ensure that the requirements of the Code are met • challenged the basis of valuations • considered the competence, expertise and objectivity of the management experts used • reviewed the qualifications of the experts used to value Level 3 investments at year end and gained an understanding of how the valuation of these investments has been reached • considered the reports on the internal controls in place for each of the fund managers • for all Level 3 investments we tested the valuation by obtaining and reviewing the audited accounts (where available) at the latest date for individual investments and agreeing these to the fund manager reports at that date • reconciled those values to the values at 31 March 2019 with reference to known movements in the intervening period • formed our own expectation on the value of level 3 investments at year end and compared these to the year end confirmations provided by the various fund managers.	Our audit work did not identify any issues in respect of the valuation of Level 3 investments.

Audit of the Financial Statements

Audit opinion

We gave an unqualified opinion on the Council's financial statements on 30 July 2019.

Preparation of the financial statements

The Council presented us with draft financial statements in accordance with the national deadline, 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. We will work with the Council to improve the process further in future years.

Issues arising from the audit of the financial statements

We reported the key issues from our audit to the Council's Audit Committee on 29 July 2019.

Annual Governance Statement and Narrative Report

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

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. After some minor amendments to the Annual Governance Statement, we confirmed that both documents were consistent with the financial statements prepared by the Council and with our knowledge of the Council.

Pension fund accounts

We gave an unqualified opinion on the pension fund accounts of Devon Pension Fund on 30 July 2019. We also reported the key issues from our audit of the pension fund accounts to the Council's Audit Committee on 29 July 2019.

Whole of Government Accounts (WGA)

We carried out work on the Council's Data Collection Tool in line with instructions provided by the NAO . We issued an assurance statement which did not identify any issues for the group auditor to consider on 29 August 2019.

Certificate of closure of the audit

We certified that we have completed the audit of the financial statements of Devon County Council in accordance with the requirements of the Code of Audit Practice on 29 August 2019.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 which specified the criterion for auditors to evaluate:

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

Key findings

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

The risks we identified and the work we performed are set out overleaf.

As part of our Audit Findings report agreed with the Council in July 2019 we agreed recommendations to address our findings.

Overall Value for Money 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 2019.

Key findings

We set out below our key findings against the significant risk we identified through our initial risk assessment.

Significant risk from the audit plan

Securing a sustainable financial future

The Council's medium term financial strategy shows that future savings will be required in order to set a balanced budget.

Audit work and Findings

The Council's budget for 2019/20 and its medium term financial strategy were agreed February 2019. 2019/20 is the last year of the Government's four year settlement and so whilst there is certainty over that year, beyond that the picture across the whole of the Local Government sector is unclear. There is a therefore a significant level of risk associated with the Council's funding arrangements from 2020/21 onwards.

The Council's anticipated savings in the coming years, as set out in its medium term financial strategy, are as follows:

	2019/20	2020/21	2021/22	2022/23
Net Budget (£000)	509,988	539,870	538,435	541,775
Savings already identified and reflected it net budget (£000)	13,398	2,155	1,464	100
Savings still to be identified (£000)	0	26,391	22,234	22,901
Total savings to be delivered (£000)	13,398	28,546	23,698	23,001
Total savings as percentage of net budget	2.6%	5.3%	4.4%	4.2%

The savings target for 2019/20 is the lowest required in the last nine years, although this rises significantly based on the Council's predictions for the next three years. Given the scale of the future savings and the time taken to develop effective savings plans, the Council may need to use some of its reserves in 2020/21 in order to achieve a balanced financial position. However, this is clearly not a sustainable position and the County Council will need to exercise restraint if it decides to use its reserves for this purpose.

The Council's transformation programme is still underway but has not delivered any savings to date nor is it expected to do so in 2019/20 and so any potential benefits of this programme have not been reflected in the Council's medium term financial strategy. It is essential to ensure that the transformation programme is kept under review to ensure that its original aims are achieved from both a service delivery and financial perspective.

Key findings

We set out below our key findings against the significant risk we identified through our initial risk assessment.

Significant risk from the audit plan	Securing a sustainable financial future (continued)
Audit work and Findings	As far as 2018/19 is concerned, the Council achieved a small underspend of £63,000, although was after transfers to and from reserves are taken into account. This positive outturn also reflects a number of one-off gains such as the business rates pilot and a revision to the minimum revenue provision and achieving savings in year was difficult, with Children's Services overspending by almost £10m. These one-off gains enabled the Council to strengthen its balance position significantly, with its General Fund and other earmarked reserves increasing by over £21m in the year. These reserves can provide a short-term buffer once the Government's settlement for 2020/21 and beyond is known.
Conclusion	The Council has adequate arrangements in place to set a balanced budget.

Key findings

We set out below our key findings against the significant risk we identified through our initial risk assessment.

Significant risk from the audit plan	**Managing demand-led services** All upper tier authorities, including Devon County Council, are experiencing significant pressures with demand-led services, especially with children's and adult's services.
Audit work and Findings	As noted on the previous page, children's services overspent by almost £10m in 2018/19 (£2.6m in 2017/18) and this area is also considered a risk in 2019/20, despite the action being taken by the Council to try to manage demand and control expenditure. Children in care remains a key pressure for all upper tier authorities, with individual care packages for the most vulnerable children often being a significant weekly cost for each placement. Although the spend has increased in Devon, the Council's analysis shows that it is still below nearest neighbours. The Council has invested in 'Edge of Care' initiatives to help address issues at source and to prevent entry of children into care in the first place. Where this is done effectively, better outcomes – both in the short and long term – can be achieved for the child, their families and the Council Tax payer. The Council has also invested funds to provide a more speedy exit from care and to support children better once they move on from being the Council's responsibility. Again, this can have a positive impact for everyone involved. The benefits of these initiatives are expected to be realised in 2020/21 and the Council should ensure that these they are closely managed in order to ensure that these initiatives are delivering the expected outcomes. Adult Care and Health Services achieved an underspend in 2018/19 of almost £700,000 in 2018/19. Although adult's services, as with children's services, is a demand-led service, this underspend has been achieved through a combination of additional funding and managing demand, with the number of cases for older people being less than in previous years. The Council recognises it needs to do more to manage demand and reduce the total costs for those aged 18 to 64 and it acknowledges that, being demand-led, the services remains a risk in 2019/20. This therefore needs to be closely managed.
Conclusion	The Council has adequate arrangements in place to identify demand pressures within key services and to take remedial action.

Key findings

We identified the following significant risk after we had completed our initial risk assessment.

Significant risk identified since our audit plan was issued	**Ofsted and Care Quality Commission (CQC) visits** During 2018/19 Ofsted and the CQC carried out a Joint Area SEND Inspection and Ofsted also undertook a two day focussed visit.
Audit work and Findings	In December 2018 a Joint Area Inspection was undertaken in Devon. The inspection included Ofsted inspectors and Inspectors from the CQC to judge the effectiveness of the area in implementing the disability and special educational needs reforms as set out in the Children and families Act 2014. This involves services for children and young people with special educational needs and / or disabilities – known as SEND. The inspection determined that a Written Statement of Action was required because of significant areas of weakness in local area's practice and noted that the local area had been too slow to implement the 2014 SEND reforms. The Council and NHS Devon CCG were jointly responsible for this Written Statement of Action. However, Ofsted considered the initial joint response as ‘not appropriate’ and have asked for a revised response from the Council and the CCG, strengthening some aspects. In May 2019 Ofsted Inspectors undertook a two day focussed visit to Devon County Council looking at the Council’s arrangements for children in need and those who are subject to a child protection plan. Ofsted reported that senior leaders, including elected members, have focussed their time and energy on creating an environment in which children can receive a better service than when the County Council’s children’s services were last inspected by Ofsted in 2015. The Council’s workforce has been stabilised at all levels and social work caseloads have been brought down to a manageable level. In all areas covered by the visit, Ofsted concluded that the Council knows its strengths and weaknesses well. However, Ofsted did report that Devon County Council has three main priorities for improving the lives of children who live in the County: timely assessments, accurate planning and consistent supervision. Ofsted reported weaknesses in all three of these areas that require decisive attention now that the infrastructure is secure. The following areas need to improve: • the quality of assessments so that these include an analysis of all presenting risks and what these mean for a child • the level of challenge and scrutiny that managers give to social workers • the focus of children in need and child protection plans so that they link directly to and address the risks identified in assessments • the accuracy of performance management data and the consistency of quality assurance audits. Ofsted will take the findings from this focussed visit into account when planning their next inspection or visit.
Conclusion	We have concluded that the issues raised by Ofsted and the Care Quality Commission do not warrant a qualification of our VFM conclusion. Nevertheless, the issues raised during the reviews are important and we made recommendations in that respect.

A. Reports issued and fees

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

Reports issued

Report	Date issued
Audit Plan	February 2019
Audit Findings Report	July 2019
Annual Audit Letter	August 2019

Fees

	Planned £	2017/18 fees £
Statutory Council audit	81,066	105,281
Audit of Pension Fund	22,024	28,603
Total fees	**103,090**	**133,884**

Audit fee variation

As outlined in our audit plan, the 2018-19 scale fees above published by PSAA of £81,066 and £22,024 assume that the scope of the audit does not significantly change. There are a number of areas where the scope of the audit has changed, which has led to additional work. These are set out in the following table.

Area	Reason	Fee proposed
Assessing the impact of the McCloud ruling	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 have reviewed the revised actuarial assessment of the impact on the financial statements along with any audit reporting requirements.	£3,000 (Council) £1,500 (Pension Fund)
Pensions – IAS 19	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 to reflect this.	£3,000
PPE Valuation – work of experts	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
Objection costs	We received an objection to the County Council's accounts in both 2016/17 and 2017/18. Both have been concluded. The fee for 2016/17 was £7,993. We have not yet determined the fee for 2017/18 and will advise the Audit Committee separately about this.	£7,993
Total		£18,493

A. Reports issued and fees continued

Non- audit services

- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The table below summarises all non-audit services which were identified.

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

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

Fees for non-audit services

Service	Expected Fee £
Audit related services - Teachers' Pensions Certification	 4,200
Non-Audit related services - Pension Assurance Letters	 10,000
Total	£14,200

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