

# Southampton City 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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The Members  
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29 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 of Southampton City Council and external stakeholders, including members of the public.

We have already reported the detailed findings from our audit work in our 2014/15 audit results report to the Governance Committee on 14 September 2015, 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

Helen Thompson  
Executive Director  
For and on behalf of Ernst & Young LLP  
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## Contents

<b>1. Executive summary .....</b>	<b>1</b>
<b>2. Key findings .....</b>	<b>3</b>
<b>3. Control themes and observations.....</b>	<b>6</b>
<b>4. Looking ahead .....</b>	<b>7</b>
<b>5. Fees .....</b>	<b>8</b>

Relevant parts of the Audit Commission Act 1998 are transitionally saved by the Local Audit and Accountability Act 2014 (Commencement No. 7, Transitional Provisions and Savings) Order 2015 for 2014/15 audits.

The Audit Commission's 'Statement of responsibilities of auditors and audited bodies' (Statement of responsibilities). It is available from the accountable officer of each audited body and via the [Audit Commission's website](#).

The Statement of responsibilities serves as the formal terms of engagement between the Audit Commission's appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The Standing Guidance serves as our terms of appointment as auditors appointed by the Audit Commission. The Standing Guidance sets out additional requirements that auditors must comply with, over and above those set out in the Code of Audit Practice 2010 (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

## 1. Executive summary

Our 2014/15 audit work was undertaken in accordance with the Audit Plan issued on 14 April 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, 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; and
- 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 statements of Southampton City Council for the financial year ended 31 March 2015 in accordance with International Standards on Auditing (UK & Ireland).	On 28 September 2015 we issued an unqualified audit opinion on the Council's financial statements.
Form a conclusion on the arrangements the Council has made for securing economy, efficiency and effectiveness in its use of resources.	On 28 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 28 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.

**Area of work**

**Result**

***As a result of the above we have also:***

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Issued a report to those charged with governance of the Council with the significant findings from our audit.

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Our Audit Results Report was issued on 2 September 2015 to the Governance Committee.

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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.

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Issued on 28 September 2015.

We will also issue a report to those charged with governance of the Council summarising the certification of grant claims and returns work we have undertaken.

## 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 28 September 2015.

Our detailed findings were reported at the 14 September 2015 Governance Committee.

The Council produced its financial statements significantly earlier this year, providing them for audit on 1 June 2015. They were of a reasonable quality, and while material adjustments were made as a result of the audit process, none affected the outturn and general fund balances.

The working papers supporting the statements were not fully complete at the start of the audit, and this should be an area for continued focus by the Council in 2015/16.

The main issues identified as part of our audit were:

#### Significant risks

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##### **Non domestic rate appeals provision**

- ▶ We identified a significant risk in this area due to changes in legislation affecting the period to which appeals can be backdated. The change also caused an increase in appeals before 31 March 2015.
- ▶ We tested the Council's provision and found it to be reasonable although, consistent with previous years, the Council's provision remains high in comparison to other benchmarked authorities, and our own estimate.

##### **Risk of management override of internal controls**

- ▶ We identify this risk on all audits we undertake as management is in a unique position to override controls.
  - ▶ Our testing found no evidence of management override of internal controls.
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#### Other key areas of focus:

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##### **Schools non-current asset accounting**

- ▶ We compared the Council's accounting for schools to a wider population of our audits, identifying that it was potentially an outlier for its treatment of voluntary controlled schools.
  - ▶ We observed that the judgements being made for schools accounting are not well explained in Note 3 to the financial statements. In our view the narrative does not consistently explain how the description of the different access and governance arrangements leads to the accounting treatment adopted.
  - ▶ There are only 3 voluntary controlled schools, and in the context of £1.1 billion total property, plant & equipment assets, we did not consider any possible mis-categorisation would materially distort the reader's understanding of the financial statements.
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### Schools Direct

- ▶ The payroll provider to a number of the Council's schools unexpectedly ceased trading during 2014/15.
- ▶ The Council's internal control arrangements mitigated against any risk of financial loss.

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### Change of bank account

- ▶ The Council changed its main bank account provider during 2014/15.
  - ▶ When implementing the change in bank accounts, we found that the Council had put appropriate controls in place to prevent material error.
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## 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 28 September 2015.

We identified a significant risk associated with the financial challenges faced by the Council, and we noted the following issues as part of our audit.

### Key finding: Financial Pressures

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The Council has a significant savings programme over the next three years to address the gaps identified in its medium term financial forecast.

Arrangements are in place to monitor and manage its 2015/16 budget, and to develop savings proposals to achieve a balanced budget for the medium term (to 2019/20). The Council's historic track record is good in both these areas.

We judged the Council still to be financially resilient for the foreseeable future. We emphasise, however, that the scale of the challenge faced is significant. It could potentially increase dependent on national pressures and the next central government spending review. It is important that the Council continues its track record of delivering its planned budget and savings. In particular, progressing the overall transformation programme and identifying clearly supported savings plans is critical to the Council's finances and the balance it has to strike against the level of services it can provide. It cannot manage this gap solely through one-off solutions or accounting adjustments, which are a significant proportion of the 2015/16 budget and the initial tranche of identified savings for 2016/17.

We expect to continue to review the Council's budget and financial planning arrangements in our 2015/16 audit.

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## 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 Council 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 Governance Committee on 14 September 2015. In our professional judgement, the firm is independent and the objectivity of the Executive Director and audit staff has not been compromised within the meaning of regulatory and professional requirements

## 2.8 Certification of grant claims and returns

We will issue the annual certification report for 2014/15 on completion of our work on the Council's housing benefit subsidy claim. We anticipate this will be in November 2015.

### 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.

We did not identify any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in the Council's financial statements.

During the year we reported opportunities for the Council to create efficiencies in how it processes financial transactions. These included examples such as:

- ▶ reviewing the need for different formats of sales invoices;
- ▶ rationalising different payrolls; and
- ▶ reducing manual processes and interventions in accounts payable.

We also commented on the continuing complexity of the Council's financial statement production process, which in our view is a further source of inefficiency if the structure of the Council's financial ledger can be simplified and more clearly linked to its statutory reporting responsibilities.

## 4. Looking ahead

Description	Impact
<p><b>Transport Infrastructure Assets:</b></p> <p>The Code of Accounting Practice for 2016/17 implements the requirement to account for Transport Infrastructure Assets. This will be a material change of accounting policy for the Council from 1 April 2016.</p>	<p>CIPFA has produced LAAP bulletin 100, which provides a suggested timetable for actions to prepare for this change.</p> <p>In common with other councils, Southampton City Council is significantly behind the proposed timetable.</p>
<p><b>Working papers:</b></p> <p>We worked closely with the Council earlier in the year to provide a comprehensive client assistance schedule (working paper requirements), specifically highlighting changes from previous years, or more complex areas.</p> <p>There were instances where we requested working papers that were not prepared as part of the closedown or provided to us at the outset of the audit.</p>	<p>Client staff had to prepare these working papers during the audit. This reduces their capacity to turnaround other audit requests especially when also balancing their normal workload.</p> <p>We will meet officers in early November 2015 to debrief on the 2014/15 accounts production and audit process. Our aim will be to identify areas for improvement to assist the Council achieve earlier completion of the audit.</p>
<p><b>Better Care Fund</b></p> <p>The Better Care Fund (BCF) is a major policy initiative between local authorities and the NHS with a primary aim of driving closer integration and improving outcomes for patients, service users and carers. From the 1 April 2015 BCF has been set up as pooled budgets. The partners use the pooled fund to jointly commission or deliver health and social care services.</p> <p>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.</p> <p>The detailed form of local pooled arrangements is not prescribed.</p>	<p>Local BCF arrangements may be complex and varied, that raise risks of misunderstanding and accounting inconsistencies between the partners. There are also structural, cultural and regulatory 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.</p> <p>In October 2014 HFMA/CIPFA produced “<i>Pooled Budgets and the Better Care Fund</i>” 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.</p>

## 5. Fees

Our fee for 2014/15 is in line with the scale fee set by the Audit Commission and reported in our 14 April 2015 Audit Plan.

	Final fee 2014/15	Planned fee 2014/15	Scale fee 2014/15	Final fee 2013/14
<b>Total Audit Fee – Code work</b>	<b>£190,286</b>	£190,286	<b>£190,286</b>	<b>£190,286</b>
<b>Total Audit Fee – Certification of claims and returns</b> <sup>1</sup>	£25,340	£25,340	£25,340	£27,632

Our actual fee is in line with the agreed fee.

We undertook no non-audit work at the Council in 2014/15.

*Notes:*

<sup>1</sup> Our fee for certification of grants and claims is yet to be finalised for 2014/15 as the work is ongoing. We plan to report this to those charged with governance within our Annual Certification Report for 2014/15

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