

# Southampton City Council

Audit results report for the year ended 31 March 2015

September 2015

Ernst & Young LLP



Building a better  
working world





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3 September 2015

Dear Members

## **Audit results report**

We are pleased to attach our audit results report for the Governance Committee. This report summarises our preliminary audit conclusion in relation to Southampton City Council's (the Council's) financial position and results of operations for the year ended 31 March 2015. We will issue our final conclusion after the Governance Committee scheduled for 14 September 2015.

Our audit is designed to express an opinion on the 2014/15 financial statements, to reach a conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources, and to address current statutory and regulatory requirements. This report contains our findings on the areas of audit emphasis, our views on the Council's accounting policies and judgments, and any significant deficiencies in internal control.

This report is intended solely for the information and use of the Governance Committee and the Council. It is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss the contents of the report with you at the forthcoming Governance Committee meeting.

Yours faithfully  
For and on behalf of Ernst & Young LLP

**Helen Thompson**

Ernst & Young LLP  
United Kingdom  
Enc.



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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 Chief Executive of each audited body and via the [Audit Commission's website](#). This document 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 Audit Results Report 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

The Council is responsible for preparing and publishing its Statement of Accounts, accompanied by an Annual Governance Statement. In this statement the Council reports publicly on the extent to which it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in the year, and any planned changes 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:

- ▶ expressing an opinion on:
  - ▶ the 2014/15 financial statements;
  - ▶ the consistency of other information published with the financial statements,
- ▶ reporting by exception where the Annual Governance Statement (AGS) does not comply with relevant guidance;
- ▶ reviewing and reporting on the Council's Whole of Government Accounts (WGA) return;
- ▶ forming a conclusion on the Council's arrangements to secure economy, efficiency and effectiveness in its use of resources; and,
- ▶ discharging the powers and duties set out in the Audit Commission Act 1998 and the Code of Audit Practice.

This report also contains our findings on the areas of audit emphasis and any significant deficiencies in internal control or views on the Council's accounting policies and judgements.

Summarised below are the conclusions from all elements of our work:

## **Financial statements**

We have performed the procedures outlined in our Audit Plan and, based on the work performed to date, we anticipate issuing an unqualified opinion on the Council's financial statements.

Our main audit findings relating to the risks set out in our Audit Plan are set out below. Further detail is included in section three of this report.

### **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 has found no evidence of management override in the work completed to date.
-

**Other financial statement risks:**

**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 observe that the judgements being made for schools accounting are not well explained in Note 3 to the financial statements. In our judgement 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 schools within this category, and in the context of £1.1 billion total property, plant & equipment assets, we do not consider any possible mis-categorisation would materially distort the reader’s understanding of the financial statements.

**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.

**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.

Until we have completed our outstanding procedures, it is possible that further matters requiring amendment may arise. We anticipate having completed these by the time of the Committee meeting on 14 September, and will provide an update to you at the meeting.

**Control themes and observations**

Our audit identified the following control issues.

- |  |   |
|--|---|
| <ul style="list-style-type: none"> <li>• Early closedown</li> </ul>                    | <ul style="list-style-type: none"> <li>▶ The Council achieved its planned early closedown of the financial statements.</li> </ul>   |
| <ul style="list-style-type: none"> <li>▶ Current year observations</li> </ul>          | <ul style="list-style-type: none"> <li>▶ There are no control failures to bring to your attention.</li> <li>▶ During the year we reported opportunities for efficiencies in the operation of your financial systems to management.</li> </ul>   |
| <ul style="list-style-type: none"> <li>▶ Update on previous recommendations</li> </ul> | <ul style="list-style-type: none"> <li>▶ Last year we highlighted the complexity of the Council’s ledger structure and process for producing its financial statements.</li> <li>▶ Some progress has been made, but it is still complex and time consuming, and in our judgement a contributory factor to some of the errors identified by our audit.</li> </ul> |
| <ul style="list-style-type: none"> <li>▶ Challenges for the coming year</li> </ul>     | <ul style="list-style-type: none"> <li>▶ CIPFA is introducing Highways Network Assets. In common with other authorities, the Council is significantly behind CIPFA’s suggested implementation programme, and has a substantial amount of preparatory work still to undertake.</li> </ul>  |

### **Summary of audit differences**

Our audit identified a number of misstatements in the accounts presented for audit, as summarised below.

- 
- ▶ Uncorrected judgemental uncertainties would increase useable reserves by £0.9 million.
  - ▶ Management have corrected misstatements amounting to £20 million overstatement of income and expenditure within Net Cost of Services. These adjustments have had no impact on useable reserves, or the reported outturn for 2014/15.
- 

### **Economy, efficiency and effectiveness**

We have performed the procedures outlined in our Audit Plan and anticipate issuing an unqualified value for money conclusion.

Our main audit findings are set out below.

#### **Significant risks:**

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##### **Financial Pressures**

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.

At this point in time we judge the Council still to be financially resilient for the foreseeable future. We emphasise, however, that the scale of the challenge being 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 through one-off solutions or accounting adjustments.

We expect to continue to review the Council's arrangements for financial resilience in our 2015/16 audit.

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##### **Whole of Government Accounts**

We are still to complete 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 have no issues to report at this stage of our work.

##### **Audit certificate**

The audit certificate is issued to demonstrate that the full requirements of the Audit Commission's Code of Audit Practice have been discharged for the relevant audit year. We expect to issue the audit certificate at the same time as the audit opinion.



## 2. Scope update

Our 2014/15 audit work has been undertaken in accordance with the Audit Plan issued on 14 April 2015, the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the Audit Commission.

Our work comprises a number of elements. Our Audit Plan provided you with an overview of our audit scope and approach for:

- ▶ expressing an opinion on:
  - ▶ the 2014/15 financial statements;
  - ▶ the consistency of other information published with the financial statements,
- ▶ reporting by exception where the Annual Governance Statement does not comply with relevant guidance;
- ▶ reviewing and reporting on the Council's Whole of Government Accounts (WGA) return;
- ▶ forming a conclusion on the Council's arrangements to secure economy, efficiency and effectiveness in its use of resources; and,
- ▶ discharging the powers and duties set out in the Audit Commission Act 1998 and the Code of Audit Practice.

We carried out our work in accordance with our Audit Plan.

### 3. Significant findings from the financial statement audit

In this section of our report we outline the main findings from our audit of your financial statements, including our conclusions on the areas of risk/ audit emphasis outlined in our Audit Plan.

#### Significant risks

##### Non domestic rate appeals provision

Description	Findings and conclusions
<p>In 2013/14 there were significant changes in the accounting arrangements for business rates, including the requirement for councils to provide for rating appeals. The Council established a methodology that included known appeals, and an estimate for those as yet unlogged.</p> <p>Due to the extension of the business rate valuation cycle to 2017, Government made changes to legislation affecting the period appeals can be backdated. After 31 March 2015, appeals made cannot be backdated to the start of the valuation period in 2010. The change may also create an increase of appeals before 31 March 2015.</p> <p>The Council will need to reassess its methodology to estimating the provision for appeals.</p> <p>Our approach focused on:</p> <ul style="list-style-type: none"> <li>▶ understanding and evaluating the Council's review of its estimation methodology for the appeals provision; and</li> <li>▶ reviewing the calculation made.</li> </ul>	<p>We found that that Council has continued its previous methodology, having considered it still to be appropriate as it wasn't based directly on appeals lodged. We have discussed the method with officers, and have concluded this was not unreasonable.</p> <p>We undertook our own assessment of the calculated provision.</p> <p>In benchmarking the value of the appeal provision, the Council continues to compare on the higher side in our comparator groups.</p> <p>We have considered whether there is any indication of management bias from this comparative exercise. We concluded there is no clear benefit to the Council to overstate the provision as a top-up authority not in receipt of a safety net payment.</p> <p>We have also raised again the same question raised in the prior year; why does the calculation use an assumption of 7.26% of the total rateable value, when the underlying calculations of historic trends show 6.99%. In our judgement management has still not clearly explained a rationale for this element other than a general inclination towards prudence which is not a specifically recognised accounting concept, a point we made in the preceding year.</p> <p>The impact of using 6.99% as opposed to 7.3% would not be material, and therefore, we accept the calculation as materially reasonable.</p> <p>Our overall judgement is that although benchmarking and our own estimate show the Council's provision remains on the high side, based on the information provided, the Council has not taken an unreasonable approach to this estimate.</p>

### Risk of management override of controls

Description	Findings and conclusions
<p>As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of their ability to directly or indirectly manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We:</p> <ul style="list-style-type: none"> <li>• tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements;</li> <li>• reviewed accounting estimates for evidence of management bias; and</li> <li>• evaluated the business rationale for any significant unusual transactions.</li> </ul>	<p>At the point of drafting this report we have not found any indications of management override.</p> <p>Our work on journals remains in progress, but those tested to date have been supported by appropriate evidence.</p> <p>We have reviewed the material accounting estimates, including the business rates provision referred to above. We have made observations on accounting practices for other estimates including the application of the accounting standard IAS37 to other provisions below.</p> <p>We have not identified any transactions we would consider to be outside of the Council's normal course of business.</p>

### Other financial statement risks

#### Schools non-current asset accounting

Description	Findings and conclusions
<p>CIPFA has issued LAAP bulletin 101, Accounting for non-current assets used by local authority maintained schools. This does not represent a change to the Code of Local Authority Accounting Practice, but additional guidance to its application.</p> <p>One of the key aspects in accounting for schools is that councils should not take a blanket approach to each category of school, but assess the individual arrangements in place.</p>	<p>We reviewed the process the Council has taken to ensuring that it has reviewed individual schools' admission arrangements against the criteria it has set whether to recognise a school on its balance sheet, or not. The Council had considered its accounting, and made no changes compared to prior years.</p> <p>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.</p> <p>We observe that the judgement being made is not well explained in Note 3 to the financial statements. For example, the disclosure note makes comparison to the arrangements for voluntary aided schools, but there is no clear explanation why the same off balance sheet judgement is made despite the differing arrangements between the two categories.</p> <p>There are only three schools within this category, and Property, Plant &amp; Equipment (PPE) overall has a net book value of £1.1 billion. Therefore, even if we disagreed with the Council's judgement, the impact would not materially distort the understanding of the financial statements.</p> <p>We also considered the treatment of voluntary aided school playing fields. Note 3</p>

### Schools non-current asset accounting

to the statements sets out that the Council is responsible for these, distinct from the school buildings and other associated property. But they are still not included in the value of the Council's assets.

Again, we consider the potential impact to be immaterial compared to the total value of PPE assets recognised in the balance sheet.

### Schools Direct

Description	Findings and conclusions
<p>The Council's financial statements include expenditure relating to many of the schools in the authority's area, excluding Academies. The payroll provider to a number of these schools, Schools Direct, unexpectedly ceased trading during the year.</p>	<p>We focused on assessing the arrangements the Council, and schools, made to ensure that schools' payrolls continued to be accurately paid and recorded in the financial statements.</p> <p>We identified a key mitigating control: the payroll provider was only transferred funds on completion of the payroll, therefore, there was no loss of money to the Council.</p> <p>The schools' payrolls were transferred to other providers.</p>

### Change of bank account

Description	Findings and conclusions
<p>The Council changed its main bank account during the year as a result of the Co-Operative bank withdrawing from the local government sector.</p>	<p>We reviewed the arrangements management implemented for the transfer. We found them to be sufficient to mitigate the risk of material error.</p>

As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we are required to report on other issues by exception. During our audit we identified the issues that are set out in the following table:

Policy/practice/finding	EY comments
<p><b>Explanatory foreword:</b> Few of the numbers quoted within the foreword are provided on the same basis, or are reconciled to, the financial statements.</p>	<p>The Explanatory Foreword includes information on the Council's budget and spending, but does not link this to the information in the financial statements.</p> <p>Local government statutory financial statements are difficult to interpret, and more use could be made of the explanatory foreword to explain the statements.</p>

## 4. Economy, efficiency and effectiveness

The Code of Audit Practice 2010 sets out our responsibility to satisfy ourselves that the Council has proper arrangements to secure economy, efficiency and effectiveness in its use of resources. In examining corporate performance management and financial management arrangements we consider the following criteria specified by the Audit Commission:

- ▶ arrangements for securing financial resilience – whether the Council has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue operating for the foreseeable future; and
- ▶ arrangements for securing economy, efficiency and effectiveness – whether the Council is prioritising its resources within tighter budgets, for example by achieving cost reductions or improving efficiency and productivity.

The table below presents the findings of our work in response to the risk areas in our Audit Plan.

### Significant risks:

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**Financial Pressures:** Reductions in central government funding, coupled with demand led pressures on its significant services, mean the Council is continuing to experience financial pressures

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### Key findings

In undertaking our work to address the identified risk, we:

- ▶ reviewed the assumptions made within the 2015/16 annual budget, and within the medium term financial forecast;
- ▶ assessed the impact of the 2014/15 revenue budget outturn, and the extent the Council achieved its planned savings, on the 2015/16 budget assumptions; and
- ▶ assessed the arrangements made in progressing the savings for the 2016/17 budget, and the progress of the Transformation Programme.

We also took into account factors such as the Council's track record of delivering its budget, and our assessment of its current financial standing and the adequacy of its reserves.

#### Setting the 2015/16 budget

The first step in our work was to assess the assumptions the Council made in setting its 2015/16 annual budget, and updating its medium term financial forecast.

We concluded the Council had set a reasonable and achievable 2015/16 budget. We similarly assessed the assumptions made within the medium term financial forecast to be reasonable.

The Council had identified planned savings of £16.7 million to address the budget gap for the year, which were reported in two tranches in September 2014 (£6.751 million) and February 2015 (£9.980 million). These were identified in advance of approving its budget, and it therefore set a balanced budget.

Our initial assessment of the planned savings at that time was that they were achievable.

We note that, in our view, it would have been better practice for the annual budget to include a full summary of the £16.7 million savings for the year.

#### Assessing the 2014/15 outturn

The Council's financial year ends on 31 March 2015, after it had set the budget for the 2015/16 year. The timing means that there could potentially be significant impacts from the outturn report that affect the assumptions made in preparing the 2015/16 budget.

The 2014/15 financial outturn was reported to Full Council in July 2015. The Council

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### Significant risks:

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delivered an underspend against its budget, with investments into reserves to mitigate future risks and fund the transformation programme.

We noted two aspects to bring to your attention.

1. The Council did not achieve its planned savings targets. There was a shortfall of £1.573 million against the planned schemes of £14.451 million. The underperformance was predominantly within the Health & Adult Social Care portfolio, which accounted for £1.427 million of the shortfall.
2. Health & Adult Social Care and Children's services portfolios both overspent their budgets, despite the use of the risk reserve and one-off sources of funding.

We assessed whether these factors presented a significant risk to the achievement to the 2015/16 budget and the planned savings for 2015/16. We identified that:

- ▶ investments have been made into both portfolios for demographic and other external factors, as set out in the 2015/16 budget paper and the medium term financial strategy; and
- ▶ for savings in Health & Adult Social Care, the level of savings in 2015/16 is smaller than originally planned for 20/14/15; £4.098 million compared to £6.8 million respectively. This gives us a degree of assurance that the portfolio is not facing an unachievable target, although it is still challenging.

Taking into account both these factors we did not judge that the 2014/15 outturn demonstrated a significantly increased risk that the Council will not deliver its 2015/16 budget. But we agreed with the Chief Financial Officer's risk assessment that the pressures in these areas continue to present a financial risk.

### Updating our assessment; how the Council is performing against its 2015/16 budget:

The next stage in our review was to reassess the initial conclusions made as the financial year 2015/16 progressed. The Council reported its performance as at the end of the first quarter, to the Cabinet in August 2015.

The headlines from the first quarter (ending 30 June 2015) were that:

- ▶ the Council projected an overspend of £9.43 million against its revenue budget; and
- ▶ savings were expected to be less than initially planned, by £3 million.

However, taking into account the Council's performance in previous years, we assess the 2015/16 budget is not unachievable and that sufficient arrangements are in place. The Council's arrangements have identified this gap in performance, implemented mitigating actions, and furthermore identified additional savings options for the year. However, it does illustrate:

1. the challenges to the Council's position and its ability to achieve the planned budget and savings, especially in services of high demand pressure such as adult and children's social care; and
2. that a large proportion of the savings are based on one-off accounting adjustments, rather than clear efficiencies in the delivery of services in their current form, or through the changes in the model of service delivery.

### Assessing progress with identifying 2016/17 savings, and the transformation programme.

In undertaking our work on value for money, we look not only at the budget and performance for the year of our audit (2014/15), and the following year, but also towards the arrangements being progressed to address the budget gaps identified over the medium term.

The Council's medium term forecast demonstrates a cumulative budget gap of around £90 million up to the end of 2019/20. The significant peaks are the next two financial years 2016/17 and 2017/18, with annual savings requirements of £39 million and £21 million respectively.

In August 2015 initial savings plans for 2016/17 were presented to the Cabinet for consultation, totalling £9.4 million. The decision paper does note, consistent with our

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### **Significant risks:**

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observation above, that only £3.9 million savings are recurrent, and therefore the remaining £5.5 million increase the gap for 2017/18.

The Council is also progressing its Transformation Programme. Updates have been provided to Members, and key milestones have been achieved of resourcing the internal programme management team and Director, and appointing the Council's strategic partner.

In the medium term financial forecast presented with the 2015/16 budget, estimates based on the initial work were that annual savings could be achieved of £9 million for 2016/17 as the programme is implemented, with a full year impact of £15 million from 2017/18. This was not included in the forecast, due to ongoing reviews. Savings proposals have still not been published for the 2016/17 budget, until the CFO is confident that they are achievable.

Taken in combination with the service savings identified to date, this indicates that the 2016/17 budget gap is still significant, with around £30 million still to be identified. This remaining gap is larger than the annual savings target in both the preceding financial years.

The report to the Cabinet identified the ongoing uncertainties and risks, for example from central government policy regarding funding.

### **Overall conclusion.**

In the stages of our work described above, reviewing the preparation of the 2015/16 budget, the effect of the 2014/15 outturn and the progress against the 2015/16 budget, we concluded that the Council had arrangements to address the challenges to its financial resilience.

However, the savings still to be identified for future years are significant, and we have carefully assessed our overall conclusion in light of the magnitude of the numbers involved.

We have taken into account:

- ▶ the arrangements in place,
- ▶ the size of the reserves available to the Council to cover any budget gap; and
- ▶ its track record of delivering its budget and a high proportion of its annual savings plans.

At this point in time we judge the Council to be financially resilient for the foreseeable future. However, that the scale of the challenge faced remains significant. It could potentially increase dependent on national pressures and the next central government spending review. It is also 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. The gap will not be able to be managed solely through one-off solutions or accounting adjustments.

We expect to continue to review the Council's arrangements for financial resilience in our 2015/16 audit.

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## 5. Control themes and observations

As part of our work, we obtained an understanding of internal control sufficient 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 are required to communicate to you significant deficiencies in internal control identified during our audit.

The matters reported below are limited to those deficiencies that we identified during the audit and that we concluded are of sufficient importance to merit being reported to you.

### 5.1 Current year observations

From the work undertaken, we have no findings or observations regarding control failures.

We did observe from our work on the Council's systems that there are a number of opportunities for efficiencies to be made in how the organisation processes financial transactions. These included examples such as:

- ▶ reviewing the need for 7 different formats of sales invoices;
- ▶ rationalising the 6 different payrolls; and
- ▶ evaluating the impact of establishing a different tolerance for accounts payable three-way matching, and whether this could facilitate a decrease in manual processes and interventions.

We reported these suggestions to management earlier in the audit, and we understand they have been incorporated into the transformation processes.

### 5.2 Status of previous year's recommendations

Description	Impact
We observed last year that the Council undertook a complex method for producing its financial statements from its ledger.	<p>The Council has taken steps to review the financial statements production process. It achieved its plan to deliver the statements by 1 June 2015.</p> <p>However, the process remains complex and time consuming. In our judgement it also contributes to the identified material error from the audit where income and expenditure were overstated due to the inclusion of internal recharges.</p> <p>The Council plans further changes to the structure of its ledger in the next two accounting periods, which may reduce the complexity and the scope for error.</p>



### 5.3 Challenges for the coming year

Description	Impact
<p><b>Transport Infrastructure Assets:</b> 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. In common with other councils, Southampton City Council is significantly behind the proposed timetable.</p>
<p><b>Working papers:</b> 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. 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. We will arrange a meeting with officers in autumn 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>

## 6. Status of our work

### 6.1 Financial statement audit

Our audit work for our opinion on the Council's financial statements is substantially complete. The following items were outstanding at the date of this report.

Item	Actions to resolve	Responsibility
Letter of representation	To be discussed at the Governance Committee on 14 September 2015.	Management and Governance Committee
Financial statements	<ul style="list-style-type: none"> <li>▶ Incorporation of EY review comments on disclosure notes</li> <li>▶ Accounts re-certified by CFO</li> <li>▶ Approval of accounts by Governance Committee.</li> <li>▶ Copy of signed Annual Governance Statement</li> </ul>	Management, Governance Committee and EY
Outstanding requested evidence of individual transactions or supporting evidence for: <ul style="list-style-type: none"> <li>• Annual Governance Statement</li> <li>• Equal pay provision</li> <li>• Payables</li> <li>• Receivables</li> <li>• Income</li> <li>• Assessment of partnership arrangements</li> <li>• Senior officers' remuneration</li> <li>• Payroll</li> <li>• Pension Contributions</li> </ul>	▶ Management to provide the requested evidence.	Management
To be completed between the date of the drafting this report and the committee: <ul style="list-style-type: none"> <li>• Housing Revenue Account</li> <li>• Capital Grants received in advance</li> </ul>	▶ EY to complete testing	EY

On the basis of our audit work to date, we anticipate issuing an unqualified auditor's report on the Council's financial statements. However, until we have completed our outstanding procedures, it is possible that further matters requiring amendment may arise.

### 6.2 Objections

We have received no objections to the 2014/15 accounts from members of the public.

## 7. Fees update

A breakdown of our fee is shown below.

	Draft final fee 2014/15 £'000	Planned fee 2014/15 £'000	Scale fee 2014/15 £'000
<b>Total Audit Fee – Code work</b>	<b>190,286 <sup>a</sup></b>	<b>190,286</b>	<b>190,286</b>
Certification of claims and return <sup>b</sup>	25,340	25,340	25,340

Notes:

a. We are unable to confirm the final fee for the audit until all work is complete. Any proposed changes to the fee will be discussed in the first instance with the Chief Financial Officer.

b. Our fee for certification of grants and claims is yet to be finalised for 2014/15 and will be reported to those charged with governance within the Annual Certification Report for 2014/15.

## 8. Summary of audit differences

In the normal course of any audit, we identify differences between amounts we believe should be recorded in the financial statements and amounts actually recorded. These differences are classified as either 'factual' or 'judgemental'. Factual differences represent items that can be accurately quantified and relate to a definite set of facts or circumstances. Judgemental differences generally involve estimation and relate to facts or circumstances which are uncertain or open to interpretation.

We determined planning materiality to be £7.3 million (2014: £7.4 million), which is 1% of gross expenditure for services reported in the accounts of £651.7 million, plus the gross expenditure amounts from the items above 'Financing, and Investment income and Expenditure' which are reported only in the Comprehensive Income and Expenditure Statement. This provided a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

We consider gross expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.

We set our tolerable error for the audit at the upper end of the available range. Tolerable error is the application of planning materiality at the individual account or balance level. It is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds planning materiality. The level of tolerable error drives the extent of detailed audit testing required to support our opinion. We set the level of tolerable error at this figure as a result of a low instance of errors, other than reclassifications, identified in previous audit years.

We agreed with the Governance Committee that we would report to the Committee all uncorrected audit differences in excess of £0.373 million (2014: £0.373 million) and these are included in our summary of misstatements below.

### 8.1 Uncorrected misstatements

We highlight the following judgemental uncertainty which has not been corrected by management. We ask the Governance Committee to consider approving management's rationale as to why these corrections have not been made and, if approved, include this in the Letter of Representation.

	Current assets	Current liabilities	Income	Expenditure	Useable Reserves	Unusable reserves
	Debit/ (Credit)	Debit/ (Credit)	Debit/ (Credit)	Debit/ (Credit)	Debit/ (Credit) Current period	Debit/ (Credit) Current period
<b>Uncorrected uncertainty</b>						
▶ Incorrect accounting for investment reserves, included as a bad debt provision.	956,000				(956,000)	
Balance sheet totals	956,000				(956,000)	

### 8.2 Corrected misstatements

We highlight in particular the following misstatements identified during the course of our audit which have been corrected by management.

- ▶ Income and expenditure in the Cost of Services was overstated by approximately £18 million for the current year. This was due to the inclusion of internal recharges.

- ▶ Income and expenditure in the Cost of Services was overstated by £1.7 million. This related to incorrect accounting for the 'Residual, Domiciliary Care and Continuing Care Services' pooled budget, where the Council recognised the contributions of other partners to the pool as income, and also the other parties' share of expenditure.
- ▶ There were errors in the lease disclosure note of approximately £49 million in the current year disclosure and £55 million in the prior period comparator.
- ▶ The notes to the cash flow contained an £18 million understatement in the disclosure of depreciation, which was included in the line for 'Impairment and downward valuations.'

Correction of these errors did not impact the Council's reported financial position.

## 9. Independence confirmation: update

We confirm there are no changes in our assessment of independence since our confirmation in our Audit Plan dated 14 April 2015. We complied with the Auditing Practices Board's Ethical Standards for Auditors and the requirements of the Audit Commission's Standing Guidance: 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.

We consider that our independence in this context is a matter that should be reviewed by both you and ourselves. It is therefore important that you consider the facts of which you are aware. If you wish to discuss any matters concerning our independence, we will be pleased to do so at the Governance Committee on 14 September 2015.

## Appendix A Required communications with the Governance Committee

There are certain communications that we must provide to the Governance Committee. These are detailed here:

Required communication	Reference
<b>Terms of engagement</b>	The Statement of responsibilities serves as the formal terms of engagement between the Audit Commission's appointed auditors and audited bodies.
<b>Planning and audit approach</b> Communication of the planned scope and timing of the audit including any limitations.	Audit Plan
<b>Significant findings from the audit</b> <ul style="list-style-type: none"> <li>▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures</li> <li>▶ Any significant difficulties encountered during the audit</li> <li>▶ Any significant matters, arising from the audit that were discussed with management</li> <li>▶ Written representations we are seeking</li> <li>▶ Expected modifications to the audit report</li> <li>▶ Any other matters significant to the oversight of the financial reporting process</li> </ul>	Audit results report
<b>Misstatements</b> <ul style="list-style-type: none"> <li>▶ Uncorrected misstatements and their effect on our audit opinion</li> <li>▶ The effect of uncorrected misstatements related to prior periods</li> <li>▶ A request that any uncorrected misstatement be corrected</li> <li>▶ In writing, corrected misstatements that are significant</li> </ul>	Audit results report
<b>Fraud</b> <ul style="list-style-type: none"> <li>▶ Enquiries of the Governance Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity</li> <li>▶ Any fraud we have identified or information we have obtained indicating that a fraud may exist</li> <li>▶ A discussion of any other matters related to fraud</li> </ul>	Enquiry made of the Committee chair and response received 26/5/2015 No other issues to report
<b>Related parties</b> Significant matters arising during the audit in connection with the entity's related parties including, when applicable: <ul style="list-style-type: none"> <li>▶ Non-disclosure by management</li> <li>▶ Inappropriate authorisation and approval of transactions</li> <li>▶ Disagreement over disclosures</li> <li>▶ Non-compliance with laws and regulations</li> <li>▶ Difficulty in identifying the party that ultimately controls the entity</li> </ul>	No issues to report
<b>External confirmations</b> <ul style="list-style-type: none"> <li>▶ Management's refusal for us to request confirmations</li> <li>▶ Inability to obtain relevant and reliable audit evidence from other procedures</li> </ul>	No issues to report

Required communication	Reference
<p><b>Consideration of laws and regulations</b></p> <ul style="list-style-type: none"> <li>▶ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off</li> <li>▶ Enquiry of the Governance Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Governance Committee may be aware of.</li> </ul>	<p>Enquiry made of the Committee chair and response received 26/5/2015 No other issues to report</p>
<p><b>Independence</b></p> <p>Communication of all significant facts and matters that bear on EY's objectivity and independence</p> <p>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> <li>▶ The principal threats</li> <li>▶ Safeguards adopted and their effectiveness</li> <li>▶ An overall assessment of threats and safeguards</li> <li>▶ Information about the general policies and process within the firm to maintain objectivity and independence</li> </ul>	<p>Audit Plan and update in section 9 of this report</p>
<p><b>Going concern</b></p> <p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> <li>▶ Whether the events or conditions constitute a material uncertainty</li> <li>▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements</li> <li>▶ The adequacy of related disclosures in the financial statements</li> </ul>	<p>No issues to report</p>
<p><b>Significant deficiencies in internal controls identified during the audit</b></p>	<p>Audit results report</p>
<p><b>Fee reporting</b></p> <ul style="list-style-type: none"> <li>▶ Final, planned and scale fee broken down into the headings of Code audit work; certification of claims and returns; and any non-audit work (or a statement to confirm that no non-audit work has been undertaken for the body).</li> </ul>	<p>Audit Plan and Audit results report</p>
<p><b>Summary of certification work undertaken</b></p> <ul style="list-style-type: none"> <li>▶ Annual report to those charged with governance summarising the certification work undertaken</li> </ul>	<p>Annual Certification Report – planned to be issued in December 2015.</p>



## Appendix B Letter of representation

[To be prepared on the entity's letterhead]

*[Date]*

Ernst & Young  
Wessex House,  
19 Threefield Lane,  
Southampton,  
SO14 3QB

This representation letter is provided in connection with your audit of the financial statements of Southampton City Council ("the Council") for the year ended 31 March 2015. We recognise that obtaining representations from us concerning the information contained in this letter is a significant procedure in enabling you to form an opinion as to whether the financial statements give a true and fair view of the financial position of Southampton City Council as of 31 March 2015 and of its expenditure and income for the year then ended in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2014/15.

We understand that the purpose of your audit of our financial statements is to express an opinion thereon and that your audit was conducted in accordance with International Standards on Auditing (UK and Ireland), which involves an examination of the accounting system, internal control and related data to the extent you considered necessary in the circumstances, and is not designed to identify - nor necessarily be expected to disclose - all fraud, shortages, errors and other irregularities, should any exist.

Accordingly, we make the following representations, which are true to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

### **A. Financial Statements and Financial Records**

1. We have fulfilled our responsibilities, under the relevant statutory authorities, for the preparation of the financial statements in accordance with the Accounts and Audit Regulations (England) 2011 and CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2014/15.
2. We acknowledge, our responsibility for the fair presentation of the financial statements. We believe the financial statements referred to above give a true and fair view of the financial position, and of its expenditure and income of the Council in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 and are free of material misstatements, including omissions. We have approved the financial statements.
3. The significant accounting policies adopted in the preparation of the financial statements are appropriately described in the financial statements.
4. We believe that the Council has a system of internal controls adequate to enable the preparation of accurate financial statements in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 that are free from material misstatement, whether due to fraud or error.
5. We do not agree that items *[specify items in question]* constitute differences because *[specify reasons for disagreement]*.

## **B. Fraud**

1. We acknowledge that we are responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud.
2. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
3. We have disclosed to you all significant facts relating to any frauds, suspected frauds or allegations of fraud known to us that may have affected the Council (regardless of the source or form and including, without limitation, allegations by “whistle-blowers”), whether involving management or employees who have significant roles in internal control. Similarly, we have disclosed to you our knowledge of frauds or suspected frauds affecting the entity involving others where the fraud could have a material effect on the financial statements. We have also disclosed to you all information in relation to any allegations of fraud or suspected fraud communicated by employees, former employees, analysts, regulators or others, that could affect the financial statements.

## **C. Compliance with Laws and Regulations**

1. We have disclosed to you all known actual or suspected noncompliance with laws and regulations whose effects should be considered when preparing the financial statements.

## **D. Information Provided and Completeness of Information and Transactions**

1. We have provided you with:
  - Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters as agreed in terms of the audit engagement.
  - Additional information that you have requested from us for the purpose of the audit and
  - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
2. All material transactions have been recorded in the accounting records and are reflected in the financial statements.
3. We have made available to you all minutes of the meetings of the Council, and committees (or summaries of actions of recent meetings for which minutes have not yet been prepared) held through the year to the most recent meeting on the following date: *[list date]*.
4. We confirm the completeness of information provided regarding the identification of related parties. We have disclosed to you the identity of the Council’s related parties and all related party relationships and transactions of which we are aware, including sales, purchases, loans, transfers of assets, liabilities and services, leasing arrangements, guarantees, non-monetary transactions and transactions for no consideration for the period ended, as well as related balances due to or from such parties at the year end. These transactions have been appropriately accounted for and disclosed in the financial statements.
5. We have disclosed to you, and the Council has complied with, all aspects of contractual agreements that could have a material effect on the financial statements in the event of

non-compliance, including all covenants, conditions or other requirements of all outstanding debt.

#### **E. Liabilities and Contingencies**

1. All liabilities and contingencies, including those associated with guarantees, whether written or oral, have been disclosed to you and are appropriately reflected in the financial statements.
2. We have informed you of all outstanding and possible litigation and claims, whether or not they have been discussed with legal counsel.
3. We have recorded and/or disclosed, as appropriate, all liabilities related litigation and claims, both actual and contingent, and have disclosed all guarantees that we have given to third parties.
4. No other claims in connection with litigation have been or are expected to be received.

#### **F. Subsequent Events**

1. Other than described in Note 6 to the financial statements, there have been no events subsequent to period end which require adjustment of or disclosure in the financial statements or notes thereto.

#### **G. Accounting Estimates**

1. We believe that the significant assumptions we used in making accounting estimates, including those measured at fair value, are reasonable.
2. For accounting estimates recognised or disclosed in the financial statements:
  - We believe the measurement processes, including related assumptions and models, we used in determining accounting estimates is appropriate and the application of these processes is consistent.
  - The disclosures relating to accounting estimates are complete and appropriate in accordance with the applicable financial reporting framework.
  - The assumptions we used in making accounting estimates appropriately reflects our intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.
  - No subsequent event requires an adjustment to the accounting estimates and disclosures included in the financial statements.

#### **H Retirement benefits**

1. On the basis of the process established by us and having made appropriate enquiries, we are satisfied that the actuarial assumptions underlying the scheme liabilities are consistent with our knowledge of the business. All significant retirement benefits and all settlements and curtailments have been identified and properly accounted for.

#### **I. Comparative information – corresponding financial information**

1. prior year adjustments have been included in the financial statements to correct a prior year error where internal recharges were included in the Cost of Services.
2. The comparative amounts have been correctly restated to reflect the above matter and

appropriate note disclosure of this restatement has also been included in the current year's financial statements.

**J. Use of the Work of an Expert**

1. We agree with the findings of the experts engaged to evaluate the valuation of property, plant and equipment, and the pension fund liability and have adequately considered the qualifications of the experts in determining the amounts and disclosures included in the financial statements and the underlying accounting records. We did not give or cause any instructions to be given to the experts with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an effect on the independence or objectivity of the experts.

*Yours Faithfully,*

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Chief Finance Officer

I confirm that this letter has been discussed and agreed at the Audit Committee on 14 September 2015

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Chairman of Governance Committee

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