

Southampton City  
Council  
Audit results report  
Year ended 31 March 2018

20 July 2018

20 July 2018



Dear Governance Committee Members

We are pleased to attach our audit results report for the forthcoming meeting of the Governance Committee. This report summarises our preliminary audit conclusion in relation to the audit of Southampton City Council for 2017/18. We will issue our final report following the Governance Committee meeting scheduled for 30 July 2018.

We have substantially completed our audit of Southampton City Council (the Council) for the year ended 31 March 2018.

Subject to concluding the outstanding matters listed in our report, we confirm that we expect to issue an unqualified audit opinion on the financial statements in the form at Section 3, before the statutory deadline of 31 July 2018. We are reporting matters about your arrangements to secure economy, efficiency and effectiveness in your use of resources.

This report is intended solely for the use of the Governance Committee, other members of the Council, and senior management. It should not be used for any other purpose or given to any other party without obtaining our written consent.

We would like to thank your staff for their help during our audit.

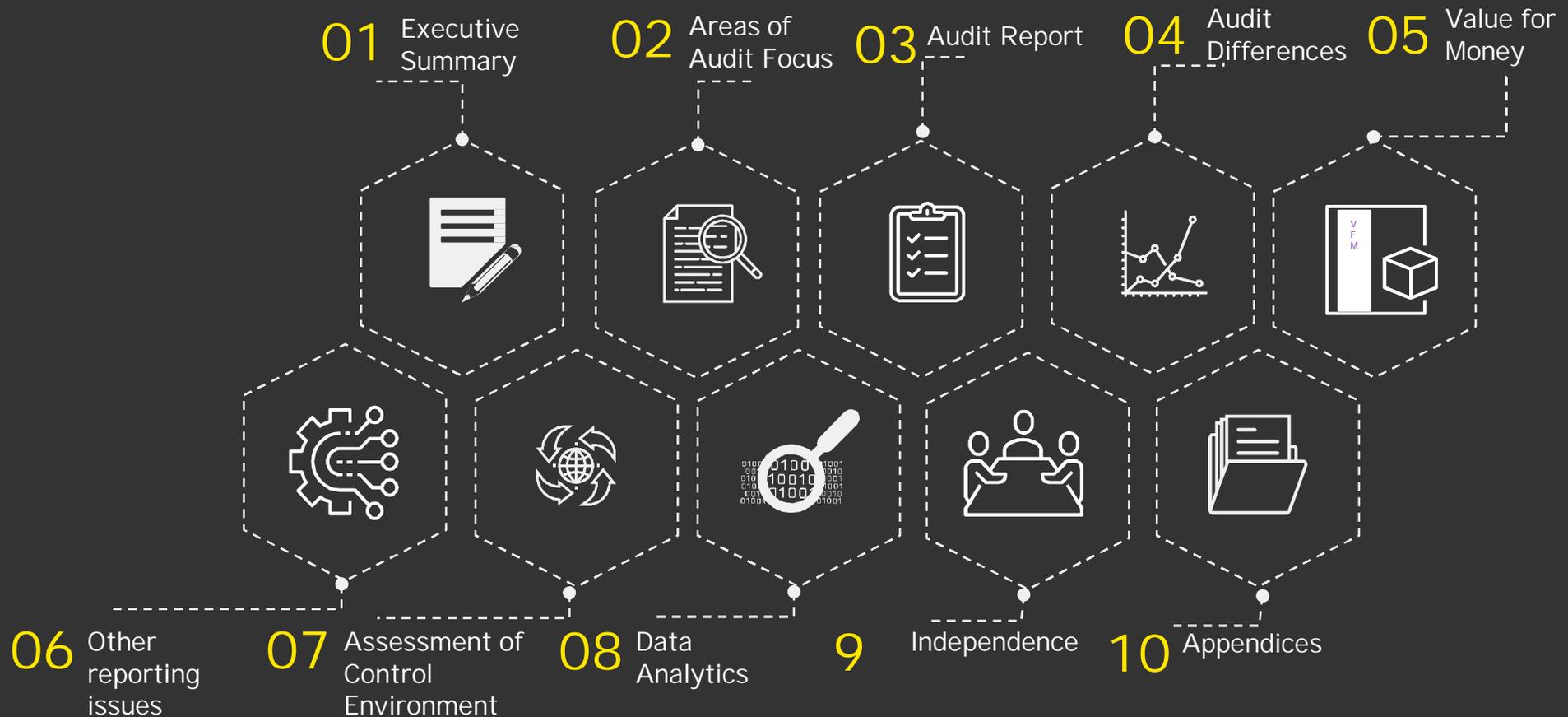
We welcome the opportunity to discuss the contents of this report with you at the Governance Committee meeting on 30 July 2018.

Yours faithfully

A handwritten signature in black ink that reads "Helen Thompson". The signature is written in a cursive style.

Helen Thompson  
Associate Partner  
For and on behalf of Ernst & Young LLP  
Encl

# Contents



In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued "Statement of responsibilities of auditors and audited bodies". It is available from the via the PSAA website ([www.PSAA.co.uk](http://www.PSAA.co.uk)). The Statement of responsibilities serves as the formal terms of engagement between 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 "Terms of Appointment (updated February 2017)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the Governance Committee and management of Southampton City Council in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Governance Committee, and management of Southampton City Council those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Governance Committee and management of Southampton City Council for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.



# 01 Executive Summary

# Executive Summary

## Scope update

In our audit planning report presented at the 12 February 2018 Governance Committee meeting, we provided you with an overview of our audit scope and approach for the audit of the financial statements. We carried out our audit in accordance with this plan, with the following exceptions:

- Changes in materiality: In our progress report to the Governance Committee in April 2018, we updated the materiality figures communicated in our audit plan to note that our audit procedures would be performed using a materiality of £13.3m. We updated our planning materiality assessment using the draft financial statements. Based on our materiality measure of gross expenditure on provision of services, we have updated our overall materiality assessment to £12.8m. This results in updated performance materiality, at 75% of overall materiality, of £9.6m (previously £10.0m), and an updated threshold for reporting misstatements of £641k (previously £663k).
- New financial statements significant risk not identified at planning stage. ISA 240 requires us to presume there is a risk of fraud in revenue and expenditure recognition and respond to it on all audit engagements unless we can rebut the presumption that it exists. Our initial assessment was that we could rebut the presumption that it exists. This is possible, for example if transactions are simple. We revised this assessment due to the complexity of the Capita guarantees coupled with the fact that the parties haven't reached agreement on the amounts due; and
- We identified an additional inherent risk related to Private Finance Initiatives (PFIs). This was reported to you in our April 2018 progress report.

Description	Detail of changes to our scope
<p>Significant Risk</p> <p>Risk of fraud in revenue and expenditure recognition identified since the planning stage.</p>	<p>As part of the Capita contract the Council has agreed procurement and digital guarantees.</p> <p>The Council has not reached agreement with Capita over the amounts payable under these guarantees. As such there is subjectivity in the amount to be recognised in 2017/18,</p> <p>For details of the work performed, see Section 2.</p>
<p>Inherent Risk</p> <p>Private Finance Initiatives (PFIs)</p> <p>Identified since the planning stage.</p>	<p>The Council has two PFIs on its Balance Sheet: PFI Schools and PFI Street Lighting.</p> <p>Accounting for PFI is a complex area. The PFI Schools and PFI Street Lighting had not been reviewed by a specialist since EY took over as your external auditors. We had been relying on specialist reviews undertaken by the Audit Commission, updated by a work program completed annually by the audit team. Due to the time lapsed since these arrangements have been subject to specialist review, we determined it was appropriate to review them this year.</p> <p>For details of the work performed, see Section 2.</p>

A summary of our approach to the audit of the balance sheet including any changes to that approach from the prior year audit is included in Appendix A.

# Executive Summary

## Status of the audit

We have substantially completed our audit of Southampton City Council's financial statements for the year ended 31 March 2018 and have performed the procedures outlined in our audit planning report. Subject to satisfactory completion of the following outstanding items we expect to issue an unqualified opinion on the Council's financial statements in the form which appears at Section 3. However until work is complete, further amendments may arise. Outstanding items are:

- Completion of procedures on property valuations, some information such as the revised valuation of Studio 144 has only been recently received (see section 2);
- receipt of information confirming the Council's and Capita's position on procurement and digital guarantees;
- the NDR (Non Domestic Rates) appeals provision;
- a discrete number of notes including the Expenditure and Funding Analysis;
- receipt of one outstanding investment confirmation;
- final review and sign off of performed audit procedures;
- review of the final version of the financial statements;
- completion of subsequent events review;
- receipt of the signed management representation letter; and
- Whole of Government Accounts (WGA): completion of procedures required by the National Audit Office (NAO) regarding the WGA submission.

We expect to issue the audit certificate after we issue the audit opinion, once the WGA submission has been completed.

## Audit differences

We identified two unadjusted audit differences in the draft financial statements. Details can be found in Section 4 Audit Differences. Management has provided a rationale for not adjusting in the draft Letter of Representation. We ask that this rationale be approved by the Governance Committee and included in the signed Letter of Representation. The impact of adjusting for these errors would be to increase unusable reserves by £7.2m. There would be no impact on usable reserves or on the General Fund balance. We agree with management's assessment that the aggregate impact of unadjusted audit differences are not material.

We have also identified audit differences which have been adjusted by management. Details can be found in Section 4 Audit Differences.

## Objections

We did not receive a valid objection to the 2017/18 accounts from the public. However, we make the following observation.

The notice of inspection of public rights was properly issued and the period of inspection ran from 9 May 2018 to 20 June 2018. During that period we received two calls from an individual experiencing difficulties in accessing the statement of accounts, initially because an incorrect contact number had been provided, and subsequently in receiving complete responses to the questions raised. The Council's final response to the questions posed was after the period of inspection rights had concluded. Management have explained that this was because they:

- received follow up questions on 15 June 2018 and they could not turnaround responses to these in time; and
- needed to consider the commercial sensitivity of some requests.

We received a formal objection on 6 July 2018. As this was outside the inspection period set out in the Accounts and Audit Regulations 2015, we were unable to accept this as an objection. However, we have taken the issues raised into account in our work on the financial statements and the value for money conclusion.

The Council should ensure, in future, that its notice of inspection rights contains accurate and complete contact details; and should make very effort to respond to questions posed during the inspection period in sufficient time to allow members of the public to exercise their rights.

## Areas of audit focus

Our audit planning report identified key areas of focus for our audit of Southampton City Council's financial statements, and we have identified new risks as set out in the scope update earlier in this executive summary. This report sets out our observations and conclusions, including our views on areas which might be conservative, and where there is potential risk and exposure. We summarise our consideration of these matters, and any others identified, in the "Key Audit Issues" section of this report.

We ask you to review these and any other matters in this report to ensure:

- there are no other considerations or matters that could have an impact on these issues;
- you agree with the resolution of the issue; and
- there are no other significant issues to be considered.

There are no matters, apart from those reported by management or disclosed in this report, which we believe should be brought to the attention of the Governance Committee.

# Executive Summary

## Control observations

We are pleased to report that the Council has made positive progress on in the following areas:

- data for our analytics work was provided to deadlines; and
- the Council has simplified the method used to produce its financial statements from its general ledger. This is a significant achievement.

We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your financial statements and which is unknown to you.

During the audit we identified one observation and improvement recommendation in relation to management's financial processes and controls. We issued an audit progress update to the April 2018 Governance Committee setting out our observations, and this is summarised in Section 7.

## Value for money

We have considered your arrangements to take informed decisions; deploy resources in a sustainable manner; and work with partners and other third parties. In our audit planning report we identified the following significant risks:

- Deploy resources in a sustainable manner: the ability of the Council to deliver the savings required to support the sustainable delivery of services.
- Take informed decisions: compliance with both procurement and contracting policies as part of a sound system of internal control.

We have the following matters to report about your arrangements to secure economy efficiency and effectiveness in your use of resources.

- We are satisfied the Council has appropriate arrangements in place to deliver the savings required to achieve its medium term financial strategy.
- Our review of the Council's arrangements found the Council has an appropriate procurement and contracting framework in. However, there is non-compliance with this framework, with the most significant issues being caused by staff failing to engage with the central procurement team. This includes breaches of both legislation and internal regulations. The consequence of such breaches could include challenge from suppliers, reputational damage to the Council and value for money not being achieved. We conclude that the Council should put central arrangements in place to monitor and enforce compliance with procurement and contract procedure rules, with clear consequences for non-compliance.

We anticipate that we will issue an 'except for' conclusion: we are satisfied with your proper arrangements to secure economy, efficiency and effectiveness in its use of resources except for weaknesses in procuring supplies and services effectively to support the delivery of strategic priorities.



# Executive Summary

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## Other reporting issues

We have reviewed the information presented in the Annual Governance Statement for consistency with our knowledge of the Council. We have the following matter to report as a result of this work:

- The Council has carried out a comprehensive review of effectiveness, and has identified a number of significant governance issues. We requested the Council include details of the matters giving risk to our qualified conclusion in relation to the weaknesses in procuring supplies and services effectively to support the delivery of strategic priorities.
- We have not yet performed the procedures required by the National Audit Office (NAO) on the Whole of Government Accounts submission. We will complete this work in August ahead of the deadline of end of August.

We have no other matters to report.

## Independence

We have no matters relating to our Independence to bring to your attention.

Please refer to Section 9 for our update on Independence.

## Use of Specialists

Our planned use specialists has not changed since our audit planning report presented at the 12 February 2018 Governance Committee meeting.



## 02 Areas of Audit Focus



## Areas of Audit Focus

### Significant risk

#### Misstatements due to fraud or error

##### What is the risk?

The financial statements as a whole are not free of material misstatements whether caused by fraud or error.

As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement. For this local government body, our assessment of risk focused our procedures in areas where the override of controls would:

- allow revenue expenditure to be met from capital resources;
- allow general fund expenditure to be met from Housing Revenue Account (HRA) resources (or visa versa); or
- benefit either the General Fund or HRA through inappropriate or omitted transactions when adjusting balances between an accounting basis and funding basis under Regulations.

##### What judgements are we focused on?

In addition to undertaking the procedures mandated by ISA240 (shown in the “What did we do?” section below), our work focussed on the following areas of potential management override:

- testing the appropriateness of Minimum Revenue Provision (MRP) charges;
- testing capital additions;
- testing the classification of expenditure treated as Revenue Expenditure Funded from Capital Under Statute (REFCUS);
- testing transfers between the General Fund and the Housing Revenue Account;
- testing adjustments made in the Movement in Reserves Statements; and
- reviewing any changes in MRP accounting policies.

##### What did we do?

- we tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in preparing the financial statements;;
- we reviewed accounting estimates for evidence of management bias; and
- we evaluated the business rationale for any significant unusual transactions.

##### What are our conclusions?

We have not identified any weaknesses in controls or evidence of management override.

We have not identified any instances of inappropriate judgements being applied. We have performed detailed testing to of each of the areas indicated opposite and identified no misstatements or indications of management override.

We have not identified any inappropriate journals from completion of our procedures in this area. This testing was supported by data analytics (See Section 9).

We have not identified any indication of management bias in accounting estimates.

We did not identify any other transactions during our audit which appeared unusual or outside the Authority’s normal course of business.



## Areas of Audit Focus

### Significant risk

#### Risk of fraud in revenue and expenditure recognition

##### What is the risk?

Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

In the Executive Summary we explained that we identified this risk after the issue of our audit planning report.

##### What judgements are we focused on?

We assessed where this risk manifests itself on this audit and are satisfied it is limited to the following area.

As part of the Strategic Services Partnership, the Council has agreed procurement and digital guarantees.

The guarantees have annual amounts which dictate cash payments to Southampton City Council but the contractual guarantee is cumulative, meaning underperformance in one period can be offset against over performance in another. While the amounts in any one year are not material, the cumulative value of the guarantees are material.

The Council has not reached agreement with Capita over the amounts payable under these guarantees. As such there is subjectivity in the amount to be recognised in 2017/18,

##### What did we do?

We planned to compare Council's and the counterparty's latest positions and conclude on the materiality of the difference.

##### What are our conclusions?

We are awaiting receipt of information confirming the Council's and their counterparty's latest position on these guarantees.

We will provide the Governance Committee an update on the outcome of our procedures on 30<sup>th</sup> July 2018.



## Areas of Audit Focus

### Other areas of audit focus

#### What is the risk/area of focus?

##### Valuation of Land and Buildings

The fair value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.

#### What did we do?

The procedures we undertook were to:

- consider the work performed by the Council's valuer, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work;
- sample testing key asset information used by the valuer in performing their valuation;
- consider the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for PPE and annually for IP. We have also considered if there are any specific changes to assets that have occurred and that these have been communicated to the valuer;
- review assets not subject to valuation in 2017/18 to confirm that the remaining asset base is not materially misstated; and
- test accounting entries have been correctly processed in the financial statements,

#### What are our findings?

Our work in this area is largely complete.

As a result of the work completed to date our only finding is that Studio 144 was incorrectly classified as an Investment Property when it should have been classified as Property, Plant and Equipment (PPE).

The Code defines Investment Properties as 'property held solely to earn rentals or for capital appreciation or both.'

As the property delivers services to the public, namely a theatre and an art gallery, it should be reclassified as Property, Plant and Equipment.

This reclassification to PPE means that Studio 144 will need to be revalued on a different valuation basis. We have recently received the revised valuation from the Council and are in the process of auditing it.

Management has agreed to amend the financial statements for this audit difference.

We engaged internal specialists from our Real Estates team to support us when making these judgements and testing the valuations prepared by the Council's valuer.

We will provide the Governance Committee with an update on the outcome of our procedures on 30<sup>th</sup> July 2018.



## Areas of Audit Focus

### Other areas of audit focus

What is the risk/area of focus?	What did we do?	What are our findings?
<p>Pension Asset/Liability Valuation</p> <p>The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Hampshire County Council.</p> <p>The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council.</p> <p>Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p>	<p>The procedures we undertook were to:</p> <ul style="list-style-type: none"> <li>• liaise with the auditors of Hampshire Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Southampton City Council;</li> <li>• assess the work of the Pension Fund actuary including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and</li> <li>• review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.</li> </ul>	<p>Our work in this area is complete.</p> <p>We have received the assurances from the Hampshire Pension Fund auditors, and are able to rely on the work of the Pension Fund actuary.</p> <p>We tested the accounting entries and disclosures in the Council's financial statements, they were consistent with the report of the Pension Fund actuary.</p> <p>We have one finding from our review of available outturn information. For timing reasons, the actuary estimates the value of the pension fund assets at 31 March 2018. This estimate was approximately £31m lower than the actual fund value as at 31 March 2018. Southampton City Council's estimated share of this variance is £3,766k.</p> <p>Management has provided a rationale for not adjusting their accounts for this difference in the draft Letter of Representation.</p> <p>We agree that this unadjusted difference is not material to the 2017/18 financial statements.</p> <p>We ask that the rationale be approved by the Governance Committee and included in the signed Letter of Representation.</p>



# Areas of Audit Focus

## Other areas of audit focus

What is the risk/area of focus?	What did we do?	What are our findings?
<p>PFI (Private Finance Initiatives) accounting</p> <p>The Council has two PFIs on its Balance Sheet: PFI Schools and PFI Street Lighting. Accounting for PFI is a complex area. The PFI Schools and PFI Street Lighting had not been reviewed by a specialist since EY took over as your external auditors. We had been relying on specialist reviews undertaken by the Audit Commission, updated by a work program completed annually by the audit team. Due to the time lapsed since these arrangements have been subject to specialist review, we determined it was appropriate to review them this year.</p>	<p>The procedures we undertook were to:</p> <ul style="list-style-type: none"> <li>• review assurances brought forward from prior years regarding the appropriateness of the PFI accounting models;</li> <li>• review the underlying contracts and subsequent variations;</li> <li>• test the appropriateness of the PFI accounting models including all inputs and assumptions;</li> <li>• agree outputs of the accounting models to the accounts; and</li> <li>• review the completeness and accuracy of disclosures.</li> </ul>	<p>Our work in this area is complete. Our work identified the following issues with the PFI accounting models:</p> <p><u>PFI Schools</u> When the PFI assets (the schools) were originally recognised on the balance sheet their cost was overstated. Subsequent revaluations mean that the carrying value of the assets has been corrected but the balance in the Revaluation Reserve is understated. By 31 March 2018, this understatement would have subsequently been offset through historic cost adjustments to the Capital Adjustment Account.</p> <p>By 31 March 2018, the impact of this reduction in cost of the PFI assets would have resulted in an increase in interest costs of £2,813k over the life of the contract. This would have been offset by an equal and opposite reduction in Minimum Revenue Provision (MRP) charges, leaving no net impact on the General Fund balance.</p> <p>To aid understandability, we have shown the net impact of these changes in Section 4.</p> <p><u>PFI Street Lighting</u> The Council's accounting model used indexed inputs to calculate the internal rate of return. The CIPFA Local Authority Accounting Code of Practice is clear that unindexed inputs should be used. By 31<sup>st</sup> March 2018, the impact of adjusting the accounting model would be a decrease in interest costs of £716k over the life of the contract with a corresponding increase in the long term PFI creditor. This would have been offset by an equal and opposite reduction in Minimum Revenue Provision (MRP) charges.</p> <p>To aid understandability, we have shown the net impact of these changes in Section 4.</p> <p>Management has provided a rationale for not adjusting their accounts for these differences in the draft Letter of Representation. We agree that these unadjusted differences are not material to the 2017/18 financial statements. We ask that the rationale be approved by the Governance Committee and included in the signed Letter of Representation.</p> <p>Our work identified no other issues with the PFI accounting models or entries and disclosures in the financial statements.</p> <p>Management has agreed to correct the unadjusted differences in their 2018/19 financials statements.</p>



# Areas of Audit Focus

## Earlier deadline for production of the financial statements

The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. The timetable for the preparation and approval of accounts was brought forward with draft accounts needing to be prepared by 31 May and the publication of the accounts by 31 July. These changes provided challenges for both the preparers and the auditors of the financial statements. While these deadlines were met last year (in advance of need), it was important for both parties to continue to work together to ensure this success was repeated. As your auditor, we now have a more significant peak in our audit work and a shorter period to complete the audit. Risks for auditors relate to delivery of all audits within same compressed timetable. Slippage at one client could potentially put delivery of others at risk. We:

- provided the Council our working paper and data analytics requests for the early substantive testing in December 2017;
- worked with the Council to facilitate early substantive testing (March 2018);
- facilitated faster close workshops to provide an interactive forum for Local Authority accountants and auditors to share good practice and ideas to enable us all to achieve a successful faster closure of accounts for the 2017/18 financial year;
- agreed the team and timing of each element of our work with management; and
- agreed with management the supporting working papers that we require to complete our audit during our planned visit in May / June 2018.

We identified the following additional specific risks to delivery at this Council:

- slippage in delivering data for analytics work; and
- the complex method the Council adopts to produce its financial statements from its ledger.

We are pleased to report that:

- data for our analytics work was provided to deadlines; and
- the Council has simplified the method used to produce its financial statements from its ledger. This is a significant achievement.

Looking forward to 2018/19, we are engaged in ongoing discussions with the finance team to simplify and improve their working papers. We are hopeful that this will enable us to conclude the audit in a shorter period.

## Other matters

**Assessment of Group Boundary:** As in the prior year, the Council identified and considered all of its arrangements and assessed them to determine whether they require consolidation into group accounts. The Council determined that no consolidation was required on the basis of materiality. We critically reviewing the reasonableness of the Council's judgement. We agreed with the Council's assessment that the production of group accounts was not required on the basis of materiality.

**IFRS 9 and IFRS 15 implementation:** new accounting standards relating to fair value measurement and revenue from contracts come into effect on 1 April 2018. The Council has undertaken an assessment of its implications, it has concluded that IFRS 9 and IFRS 15 is unlikely to have a material impact on the single entity financial statements of the Council. We concur with the Council's initial assessment.



# 03 Audit Report



# Audit Report

## Draft audit report

### Our draft audit report

#### INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SOUTHAMPTON CITY COUNCIL

##### Opinion

We have audited the financial statements of Southampton City Council for the year ended 31 March 2018 under the Local Audit and Accountability Act 2014. The financial statements comprise the Authority Movement in Reserves Statement; Comprehensive Income and Expenditure Statement; Balance Sheet; Cash Flow Statement; related notes 1 to 40 and the Expenditure Funding Analysis; the Housing Revenue Account Income and Expenditure Statement; Statement of Movement on the Housing Revenue Account and related notes 1 to 5; and the Collection Fund and related notes 1 to 2.

The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.

In our opinion the financial statements:

- give a true and fair view of the financial position of Southampton City Council as at 31 March 2018 and of its expenditure and income for the year then ended; and
- have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.

##### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the authority in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard and the Comptroller and Auditor General's AGN01, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

##### Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Section 151 Officer's use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Section 151 Officer has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Authority's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.



# Audit Report

## Our draft audit report

### Other information

The other information comprises the following information published with the financial statements and our auditor's report thereon: the Preface, Narrative Statement, Statement of Responsibilities, Glossary and Annual Governance Statement. The Section 151 Officer is responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinion on other matters prescribed by the Local Audit and Accountability Act 2014

Arrangements to secure economy, efficiency and effectiveness in use of resources

### Basis for Qualified Conclusion

In August 2017, following concerns raised with us in relation to possible impropriety in procurement and contracting arrangements, investigations undertaken found:

- breaches of legislation as a result of non-compliance with the Council's procurement processes; and
- non-compliance with internal procurement rules for nominating subcontractors.

This issue is evidence of weaknesses in proper arrangements for procuring supplies and services effectively to support the delivery of strategic priorities.

### Qualified conclusion

In our opinion, based on the work undertaken in the course of the audit, having regard to the guidance issued by the Comptroller & Auditor General in August 2017, with the exception of the matter(s) reported in the basis for qualified conclusion paragraph above, we are satisfied that, in all significant respects, Southampton City Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.

### Matters on which we report by exception

We report to you if:

- in our opinion the annual governance statement is misleading or inconsistent with other information forthcoming from the audit or our knowledge of the Council;



# Audit Report

## Our draft audit report on the financial statements

- we issue a report in the public interest under section 24 of the Local Audit and Accountability Act 2014;
- we make written recommendations to the audited body under Section 24 of the Local Audit and Accountability Act 2014;
- we make an application to the court for a declaration that an item of account is contrary to law under Section 28 of the Local Audit and Accountability Act 2014;
- we issue an advisory notice under Section 29 of the Local Audit and Accountability Act 2014; or
- we make an application for judicial review under Section 31 of the Local Audit and Accountability Act 2014.

We have nothing to report in these respects.

### Responsibility of the Section 151 Officer

As explained more fully in the Statement of the Section 151 Officer's Responsibilities set out on page 22, the Section 151 Officer is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18, and for being satisfied that they give a true and fair view.

In preparing the financial statements, the Section 151 Officer is responsible for assessing the Authority's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Authority either intends to cease operations, or have no realistic alternative but to do so.

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

### Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

### Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources

We have undertaken our review in accordance with the Code of Audit Practice, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General in August 2017, as to whether Southampton City Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. The Comptroller and Auditor General determined this criterion as that necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether Southampton City Council put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.



# Audit Report

## Our draft audit report on the financial statements

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to form a view on whether, in all significant respects, Southampton City Council had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

We are required under Section 20(1)(c) of the Local Audit and Accountability Act 2014 to satisfy ourselves that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the National Audit Office (NAO) requires us to report to you our conclusion relating to proper arrangements.

We report if significant matters have come to our attention which prevent us from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

### Delay in certification of completion of the audit

We cannot formally conclude the audit and issue an audit certificate until we have completed the work necessary to issue our assurance statement in respect of the Authority's Whole of Government Accounts consolidation pack. We are satisfied that this work does not have a material effect on the financial statements or on our value for money conclusion.

### Use of our report

This report is made solely to the members of Southampton City Council, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014 and for no other purpose, as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Southampton City Council and the Southampton City Council members as a body, for our audit work, for this report, or for the opinions we have formed.

Helen Thompson (Associate Partner)

Ernst & Young LLP (Local Auditor)

Southampton

XX July 2018

The maintenance and integrity of the Southampton City Council web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.



# 04 Audit Differences





## Audit Differences

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In the normal course of any audit, we identify misstatements between amounts we believe should be recorded in the financial statements and the disclosures and amounts actually recorded. These differences are classified as “known” or “judgemental”. Known 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 that are uncertain or open to interpretation.

### Summary of adjusted differences

We would highlight adjusted misstatements greater than £9.6m which have been corrected by management that were identified during the course of our audit. We have identified no such errors to date. We will provide a verbal update to the Governance Committee after completion of our outstanding procedures listed in the Executive Summary.

# Audit Differences

## Summary of unadjusted differences

In addition we highlight the following misstatements to the financial statements and/or disclosures which were not corrected by management. Management has provided a rationale for not adjusting their accounts for these differences in the draft Letter of Representation. We agree that these unadjusted differences are not individually or cumulatively material to the 2017/18 financial statements. We ask that the rationale be approved by the Governance Committee and included in the signed Letter of Representation.

Uncorrected misstatements 31 March 2018 (£000) 	 Effect on the current period:	 Balance Sheet (Decrease)/Increase			
	CIES Debit/(Credit)	Assets current Debit/ (Credit)	Assets non current Debit/ (Credit)	Liabilities current Debit/ (Credit)	Liabilities non- current Debit/ (Credit)
<b>Errors- Known differences.</b>					
PFI Schools - details reported in Section 2 (net impact)					
• Interest expense (total impact from start of contract)	2,813				
• Long Term creditor - PFI Liability				2,715	
• Revaluation Reserve					(4,533)
• Capital Adjustment Account					1,818
• General Fund					(2,813)
PFI Street lighting - details reported in Section 2 (net impact)					
• Interest expense (total impact from start of contract)	(716)				
• Long Term creditor - PFI Liability				716	
• Capital Adjustment Account					(716)
• General Fund					716
Details reported in Section 2 under Pension Asset/Liability Valuation.					
• Pension liability				3,766	
• Pension reserve					(3,766)
<b>Balance sheet totals</b>				<b>7,197</b>	<b>(9,294)</b>
<b>Income effect of uncorrected misstatements</b>	<b>2,097</b>				



# Audit Differences

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## Summary of unadjusted differences

In addition we highlight the following misstatements to the financial statements and/or disclosures which were not corrected by management. Management has provided a rationale for not adjusting their accounts for these differences in the draft Letter of Representation. We agree that these unadjusted differences are not individually or cumulatively material to the 2017/18 financial statements. We ask that the rationale be approved by the Governance Committee and included in the signed Letter of Representation.

### Uncorrected disclosure misstatement

PFI Schools. Note 31 – future obligations. As a result of the unadjusted errors to the PFI liability recorded above, the future interest obligations will be understated by £2,715k and the finance lease liability repayments overstated by a corresponding amount.

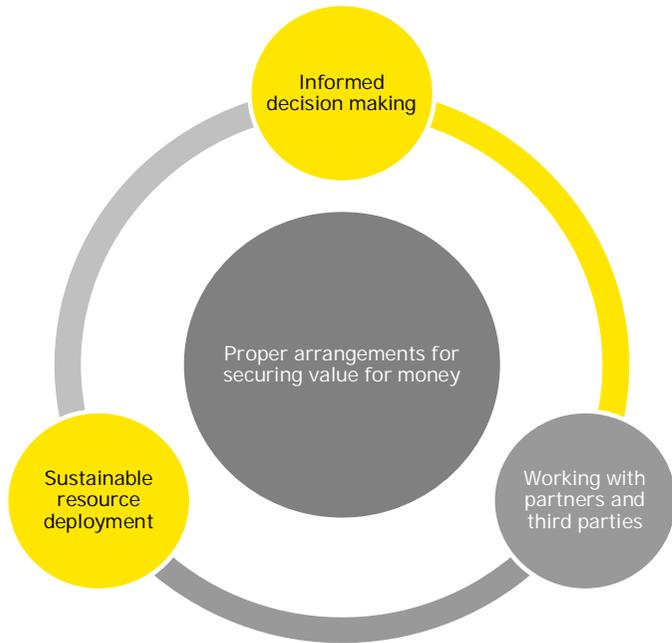
PFI Street lighting. Note 31 – future obligations. As a result of the unadjusted errors to the PFI liability recorded above, the future interest obligations will be understated by £716k and the finance lease liability repayments overstated by a corresponding amount.



05

## Value for Money Risks





## Background

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

For 2018/19 this is based on the overall evaluation criterion:

"In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people"

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- § Take informed decisions;
- § Deploy resources in a sustainable manner; and
- § Work with partners and other third parties.

In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

## Overall conclusion

We identified two significant risks around these arrangements. The tables below present our findings in response to the risks in our audit planning report.

We therefore expect having the following matters to report about your arrangements to secure economy, efficiency and effectiveness in your use of resources.

- We are satisfied the Council has appropriate arrangements in place to deliver the savings required to achieve its medium term financial strategy.
- Our review of the Council's arrangements found the Council has an appropriate procurement and contracting framework in. However, there is non-compliance with this framework, with the most significant issues being caused by staff failing to engage with the central procurement team. This includes breaches of both legislation and internal regulations. The consequence of such breaches could include challenge from suppliers, reputational damage to the Council and value for money not being achieved. We conclude that the Council should put central arrangements in place to monitor and enforce compliance with procurement and contract procedure rules, with clear consequences for non-compliance.

We anticipate that we will issue an 'except for' conclusion: we are satisfied with your proper arrangements to secure economy, efficiency and effectiveness in its use of resources except for weaknesses in procuring supplies and services effectively to support the delivery of strategic priorities.



## Value for Money Risks

We are only required to determine whether there are any risks that we consider significant within the Code of Audit Practice, where risk is defined as:

*"A matter is significant if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public"*

Our risk assessment supports the planning of enough work to deliver a safe conclusion on your arrangements to secure value for money, and enables us to determine the nature and extent of any further work needed. If we do not identify a significant risk we do not need to carry out further work.

We present below the findings of our work in response to the risks areas in our Audit Planning Report.

### What is the significant value for money risk?

Compliance with both procurement and contracting policies as part of a sound system of internal control

### What arrangements does the risk affect?

Working with partners and other third parties through in procuring supplies and services effectively to support the delivery of strategic priorities

### What are our findings?

Review of the Council's arrangements found the Council has an appropriate procurement and contracting framework in place. However, there is non-compliance with this framework, with the most significant instances being caused by staff failing to engage with the central procurement team. This includes:

- non compliance with EC Procurement Regulations that require contracts over set thresholds to be awarded using an OJEU (Official Journal of the European Union) compliant procurement. For one contract over these thresholds, guidance was issued in 2017 by the central procurement team to go to market through the appropriate procurement route. This action still has not been completed.
- failure to adhere to internal procurement rules for nominating subcontractors.
- significant levels of non-compliance with the sub £100k procurement process. This has been regularly reported to the Governance Committee.

Potential consequences of these breaches could include: challenge from suppliers, reputational damage to the Council and value for money not being achieved.

While auditors do not need to gather evidence of outcomes in order to conclude on the adequacy of arrangements in place, we are required to take account of evidence drawn from outcomes where it suggests that there may be significant weaknesses in arrangements. We have considered outcomes related to these arrangements, most notably in the case of Studio 144.

Fundamentally, central arrangements need to be put in place to monitor and enforce compliance with procurement and contract procedure rules. There must be clear consequences for those who fail to comply.

### What is our conclusion?

The Council should put central arrangements in place to monitor and enforce compliance with procurement and contract procedure rules, with clear consequences for non-compliance.



# Value for Money

## What is the significant value for money risk?

The Council's ability to deliver the savings required to support the sustainable delivery of services

## What arrangements does the risk affect?

Deploying resources in a sustainable manner

## Our approach

- reviewing achievement of the 2017/18 budget.
- reviewing achievement of planned savings in 2017/18; and
- reviewing the arrangement in place to deliver the savings plans in 2018/19 onwards.

## What are our findings?

The 2017/18 financial outturn reported a portfolio overspend of (£3.3m) compared to (£3.67m) in 2016/17. After savings in other areas, release of the risk reserve and approved movements from balances, the Council's outturn allowed an additional transfer to reserves of £5.04m (£4.97m in 2016/17). This contributed to the in year increase in General Fund reserves of £12.5m.

The largest portfolio overspend was in Health and Adult Social Care (£3.7m) in 2017/18 compared to (£5.46m) 2016/17. This was consistently identified and monitored in corporate financial monitoring reports throughout the year. This will continue to be a key area of focus for the Council in 2018/19. Arrangements are in place to monitor savings through intensive care budget meetings chaired by the Chief Executive.

As year end, the Council achieved savings of £18.54m against its 2017/18 savings target of £23.93m. This represents 77% of the target. The RAG rating of each individual scheme and the forecast year end position is updated monthly. This is reported to directors, Council's Management Team (CMT) and the Cabinet Member for Finance. It is also taken to Cabinet through quarterly financial monitoring reports. These reports accurately projected achieved savings throughout the year.

We have reviewed the Council's MTFS and arrangements to deliver its planned savings in 2018/19. The Council's budgeted saving plans for 2018/19 are £24.4m. We have reviewed the process to identify and agree detailed savings plans for 2018/19 and found it to be robust. As in 2017/18, appropriate arrangements are in place to ensure accountability and good governance through monitoring of savings by Service Directors, the Council's Management Team and Cabinet. The Council is currently forecasting achieving 90% or £22.1m of its 2018/19 savings target (as at Q1). Any shortfall in delivering these savings plans could be offset against earmarked reserves held by the Council, such as the £32.1m MTFS reserve that has prudently been set aside for this purpose.

## What is our conclusion?

Based on the factors and considerations set out above, we consider that the Council continues to have appropriate arrangements in place to deliver services sustainably.



# 06 Other reporting issues



## Other reporting issues

### Consistency of other information published with the financial statements, including the Annual Governance Statement

We must give an opinion on the consistency of the financial and non-financial information in the Financial Statements 2017/18 with the audited financial statements.

Financial information in the Financial Statements 2017/18 and published with the financial statements was consistent with the audited financial statements.

We must also review the Annual Governance Statement for completeness of disclosures, consistency with other information from our work, and whether it complies with relevant guidance.

We have the following matter to report as a result of this work:

- The Council has carried out a comprehensive review of effectiveness, and has identified a number of significant governance issues. We requested the Council include details of the matters giving risk to our qualified conclusion in relation to the weaknesses in procuring supplies and services effectively to support the delivery of strategic priorities.

### Whole of Government Accounts

Alongside our work on the financial statements, we also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of our review, and the nature of our report, is specified by the National Audit Office.

We are planning to complete our work prior to the deadline in August 2018 and will report any matters arising to the Governance Committee.

# Other reporting issues

### Other powers and duties

We have a duty under the Local Audit and Accountability Act 2014 to consider whether to report on any matter that comes to our attention in the course of the audit, either for the Council to consider it or to bring it to the attention of the public (i.e. "a report in the public interest"). We did not identify any issues which required us to issue a report in the public interest.

We also have a duty to make written recommendations to the Council, copied to the Secretary of State, and take action in accordance with our responsibilities under the Local Audit and Accountability Act 2014. We did not identify any issues.

We did not receive a valid objection to the 2017/18 accounts from the public. However, we note the observations made in the Executive Summary.

### Other matters

As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we must tell you significant findings from the audit and other matters if they are significant to your oversight of the Authority's financial reporting process. They include the following.

- significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures;
- any significant difficulties encountered during the audit;
- any significant matters arising from the audit that were discussed with management;
- written representations we have requested;
- expected modifications to the audit report;
- any other matters significant to overseeing the financial reporting process;
- findings and issues around the opening balance on initial audits (if applicable);
- related parties;
- external confirmations;
- going concern;
- consideration of laws and regulations.

The matters we need to report to you are:

- management made a prior year adjustment to correct an error in Note 31 – future minimum lease payments under operating leases. This is appropriately disclosed in Note 5 of the financial statements.
- we have requested a rationale as to why the unadjusted errors, reported in Section 5, have not been corrected be included in the Letter of Representation;
- we have requested one investment confirmation that has not been provided by a counterparty; and
- while completing our procedures on the VFM conclusion, we have become aware of non compliance with laws and regulations. This relates to non compliance with EC Procurement Regulations that require contracts over set thresholds to be awarded using an OJEU (Official Journal of the European Union) compliant procurement.



07

## Assessment of Control Environment

# Assessment of Control Environment

## Financial controls

It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. As we have adopted a fully substantive approach, we have therefore not tested the operation of controls.

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.

We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your financial statements of which you are not aware.

During the audit we identified one observation and improvement recommendation in relation to management's financial processes and controls:

- Our Income Collection and Banking walkthrough identified that vendor accounts were not being updated in a timely manner on receipt of payments. In November 2017, approximately £3m of receipts were held in a cash suspense account, unmatched to vendor accounts. This means that vendor accounts would appear to be in arrears when they had in actual fact been paid, and could lead to arrears recovery action being inappropriately taken. We reported this issue to the Service Director Finance & Commercialisation in November 2017 and the issue was promptly rectified.

## Reliance on internal audit

Our review and evaluation of controls is performed in conjunction with Internal Audit to minimise duplication and to rely on their work where appropriate.

We continue to work closely with Internal Audit to co-ordinate the delivery of the assurance work. During the year we have met with Internal Audit on a number of occasions to discuss the scope of their work and their findings.

We have reviewed Internal Audit reports issued to management during the period to 20 July 2018 and selected working papers to ensure that any financial statement risks identified are considered in determining the extent of our audit procedures.



# 08 Data Analytics



## Analytics Driven Audit

### Data analytics

We used our data analysers to enable us to capture entire populations of your financial data. These analysers:

- Help identify specific exceptions and anomalies which can then be the focus of our substantive audit tests; and
- Give greater likelihood of identifying errors than traditional, random sampling techniques.

In 2017/18, our use of these analysers in the authority's audit included testing journal entries and employee expenses, to identify and focus our testing on those entries we deem to have the highest inherent risk to the audit.

We capture the data through our formal data requests and the data transfer takes place on a secured EY website. These are in line with our EY data protection policies which are designed to protect the confidentiality, integrity and availability of business and personal information.

#### Journal Entry Analysis

We obtain downloads of all financial ledger transactions posted in the year. We perform completeness analysis over the data, reconciling the sum of transactions to the movement in the trial balances and financial statements to ensure we have captured all data. Our analysers then review and sort transactions, allowing us to more effectively identify and test journals that we consider to be higher risk, as identified in our audit planning report.

#### Payroll Analysis

We also use our analysers in our payroll testing. We obtain all payroll transactions posted in the year from the payroll system and perform completeness analysis over the data, including reconciling the total amount to the General Ledger trial balance. We then analyse the data against a number of specifically designed procedures. These include analysis of payroll costs by month to identify any variances from established expectations, as well as more detailed transactional interrogation.



09

Independence

## Confirmation



We confirm that there are no changes in our assessment of independence since our confirmation in our audit planning board report dated February 2018.

We complied with the FRC Ethical Standards and the requirements of the PSAA's Terms of Appointment. 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 which you should review, as well as us. It is important that you and your Governance Committee consider the facts known to you and come to a view. If you would like to discuss any matters concerning our independence, we will be pleased to do this at the meeting of the Governance Committee on 30 July 2018.

# Independence



## Relationships, services and related threats and safeguards



The FRC Ethical Standard requires that we provide details of all relationships between Ernst & Young (EY) and your Council, and its directors and senior management and its affiliates, including all services provided by us and our network to your Council, its directors and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on the our integrity or objectivity, including those that could compromise independence and the related safeguards that are in place and why they address the threats.

There are no relationships from 1 April 2017 to the date of this report, which we consider may reasonably be thought to bear on our independence and objectivity.

### Services provided by Ernst & Young

Below includes a summary of the fees that you have paid to us in the year ended 31 March 2018 in line with the disclosures set out in FRC Ethical Standard and in statute.

As at the date of this report, there are no future services which have been contracted and no written proposal to provide non-audit services has been submitted.

# Independence

## Fee analysis

As part of our reporting on our independence, we set out below a summary of the fees paid for the year ended 31 March 2018].

We confirm that we have not undertaken non-audit work outside the Public Sector Audit Appointments Ltd. (PSAA) Code requirements.

	Final Fee 2017/18	Planned Fee 2018/18	Scale Fee 2017/18	Final Fee 2016/17
	£	£	£	£
Total Audit Fee – Code work	TBC*	142,715	142,715	147,101****
Non-audit work [Housing Benefit Subsidy grant claim]	TBC**	19,524	19,524***	15,204*****
Total non-audit services	TBC	19,524	19,524	15,204

\*The final fee for the 2017/18 account audit is still to be quantified. We anticipate an increase in fee above the scale fee, to be agreed with the Service Director of Finance and Commercialisation (s151 officer) in relation to the additional work related to:

- the matters giving rise to the anticipated 'except for' conclusion on the Council's proper arrangements to secure economy, efficiency and effectiveness in its use of resources;
- correspondence related to a formal objection; and
- involvement of an auditor's specialist in the audit of property valuations.

These will also need to be approved by PSAA. The final fee will be reported to you in our Annual Audit Letter.

\*\* Our final fee for the 2017/18 HB certification will be reported to you in our Grant Claim Certification Report once the work is complete. The deadline for completion of this work is 30<sup>th</sup> November 2018.

\*\*\* The scope of the 2017/18 HB certification has been agreed with officers. In 2016/17, the Council performed some of the initial Housing Benefit certification testing itself in return for a reduction in fee. For 2017/18 it has been agreed that we will revert to the previous arrangement where we completed the initial testing, hence the increase in fee.

\*\*\*\* We reported to you in our July 2017 Audit Results Report that for 2016/17 that a fee variation of £4,386 was agreed for additional work in: agreeing your financial statements to the general ledger (due to the complexity of the methodology) and assessing the impact of uncorrected errors.

\*\*\*\*\* We reported to you in our July 2017 Audit Results Report that for 2016/17, the Council performed some of the initial Housing Benefit certification testing itself in return for a 20% or £3,801 reduction in our fee. This has now been agreed with PSAA.



# 10 Appendices

## Appendix A

# Audit approach update

We summarise below our approach to the audit of the balance sheet and any changes to this approach from the prior year audit.

Our audit procedures are designed to be responsive to our assessed risk of material misstatement at the relevant assertion level. Assertions relevant to the balance sheet include:

- Existence: An asset, liability and equity interest exists at a given date
- Rights and Obligations: An asset, liability and equity interest pertains to the entity at a given date
- Completeness: There are no unrecorded assets, liabilities, and equity interests, transactions or events, or undisclosed items
- Valuation: An asset, liability and equity interest is recorded at an appropriate amount and any resulting valuation or allocation adjustments are appropriately recorded
- Presentation and Disclosure: Assets, liabilities and equity interests are appropriately aggregated or disaggregated, and classified, described and disclosed in accordance with the applicable financial reporting framework. Disclosures are relevant and understandable in the context of the applicable financial reporting framework

Balance sheet category 	Audit Approach in prior year 	Audit Approach in current year 	Explanation for change 
Short term debtors Short term creditors Cash	We tested controls over all relevant assertions which reduced the extent of substantive testing required to be performed in accordance with auditing standards	Substantively tested all relevant assertions. We placed no reliance on the operation of controls.	The reason for the change was efficiency. There is no change in the level of assurance provided by our work.
All other areas	Substantively tested all relevant assertions. We placed no reliance on the operation of controls.	Substantively tested all relevant assertions. We placed no reliance on the operation of controls.	No change

## Appendix B

# Summary of communications

Date 	Nature 	Summary 
20 <sup>th</sup> November 2017	Meeting	The partner in charge of the engagement, along with other senior members of the audit team, met with the management team to discuss progress and developments.
9 <sup>th</sup> January 2018	Meeting	The partner in charge of the engagement, along with other senior members of the audit team, met with the management team to discuss progress and developments.
1 <sup>st</sup> February 2018	Report	The audit planning report, including confirmation of independence, was issued to the Governance Committee.
12 <sup>th</sup> February 2018	Committee	The partner in charge of the engagement, accompanied by other senior members of the audit team, met with the Governance Committee and senior members of the management team to discuss progress and developments.
20 <sup>th</sup> February 2018	Meeting	The partner in charge of the engagement, along with other senior members of the audit team, met with the management (including the Chief Executive) to discuss progress and developments.
11 <sup>th</sup> April 2018	Meeting	The partner in charge of the engagement, along with other senior members of the audit team, met with the management team to discuss progress and developments.
23 <sup>rd</sup> April 2018	Committee	The partner in charge of the engagement, accompanied by other senior members of the audit team, met with the Governance Committee and senior members of the management team to discuss the audit progress report.
9 <sup>th</sup> May 2018	Meeting	The partner in charge of the engagement, accompanied by other senior members of the audit team, met with the Governance Committee and senior members of the management team to discuss progress and developments.
20 <sup>th</sup> June 2018	Meeting	Audit close meeting with the management team to discuss the preliminary findings of the audit.
20 <sup>th</sup> July 2018	Report	The audit results report, including confirmation of independence, was issued to the Governance Committee.
30 <sup>th</sup> July 2018	Committee	The partner in charge of the engagement, accompanied by other senior members of the audit team, met with the Governance Committee and senior members of the management team to discuss the audit results report.

In addition to the above specific meetings, with senior members of the audit team and management, the audit team met with the management team multiple times throughout the audit to discuss audit progress.

## Appendix C

# Required communications with the Governance Committee

There are certain communications that we must provide to the audit committees of UK clients. We have detailed these here together with a reference of when and where they were covered:

		 Our Reporting to you
 Required communications	 What is reported?	 When and where
Terms of engagement	Confirmation by the Governance Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter.	Audit planning report February 2018
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit planning report February 2018
Significant findings from the audit	<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>• Significant difficulties, if any, encountered during the audit</li> <li>• Significant matters, if any, arising from the audit that were discussed with management</li> <li>• Written representations that we are seeking</li> <li>• Expected modifications to the audit report</li> <li>• Other matters if any, significant to the oversight of the financial reporting process</li> </ul>	Audit Results Report 20 July 2018

## Appendix C

		 Our Reporting to you
Required communications	 What is reported?	 When and where
Going concern	<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>	No conditions or events were identified, either individually or together to raise any doubt about Southampton City Council's ability to continue for the 12 months from the date of our report
Misstatements	<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>• Material misstatements corrected by management</li> </ul>	Audit Results Report 20 July 2018
Subsequent events	<ul style="list-style-type: none"> <li>• Enquiry of the Governance Committee where appropriate regarding whether any subsequent events have occurred that might affect the financial statements.</li> </ul>	By letter of representation request in Audit Results Report 16 July 2018
Fraud	<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 Council</li> <li>• Any fraud that we have identified or information we have obtained that indicates that a fraud may exist</li> <li>• Unless all of those charged with governance are involved in managing the Council, any identified or suspected fraud involving:               <ol style="list-style-type: none"> <li>a. Management;</li> <li>b. Employees who have significant roles in internal control; or</li> <li>c. Others where the fraud results in a material misstatement in the financial statements.</li> </ol> </li> <li>• The nature, timing and extent of audit procedures necessary to complete the audit when fraud involving management is suspected</li> <li>• Any other matters related to fraud, relevant to Governance Committee responsibility.</li> </ul>	Audit Results Report 20 July 2018

# Appendix C

		Our Reporting to you
Required communications	What is reported?	When and where
Related parties	<p>Significant matters arising during the audit in connection with the Council’s related parties including, when applicable:</p> <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 Council</li> </ul>	Audit Results Report 20 July 2018
Independence	<p>Communication of all significant facts and matters that bear on EY’s, and all individuals involved in the audit, 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>Communications whenever significant judgments are made about threats to objectivity and independence and the appropriateness of safeguards put in place.</p>	Audit planning report February 2018 and Audit Results Report 20 July 2018

## Appendix C

		 Our Reporting to you
Required communications	 What is reported?	 When and where
External confirmations	<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>	We have requested investment confirmation that has not been provided by a counterparty. We will provide a verbal update to the Governance Committee on 30 <sup>th</sup> July 2018.
Consideration of laws and regulations	<ul style="list-style-type: none"> <li>• Subject to compliance with applicable regulations, matters involving identified or suspected non-compliance with laws and regulations, other than those which are clearly inconsequential and the implications thereof. Instances of suspected non-compliance may also include those that are brought to our attention that are expected to occur imminently or for which there is reason to believe that they may occur</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>	We have asked management and those charged with governance by letter of representation. We have not identified any material instances or non-compliance with laws and regulations.
Significant deficiencies in internal controls identified during the audit	<ul style="list-style-type: none"> <li>• Significant deficiencies in internal controls identified during the audit.</li> </ul>	Audit Results Report 20 July 2018
Written representations we are requesting from management and/or those charged with governance	<ul style="list-style-type: none"> <li>• Written representations we are requesting from management and/or those charged with governance</li> </ul>	Audit Results Report 20 July 2018
Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	<ul style="list-style-type: none"> <li>• Material inconsistencies or misstatements of fact identified in other information which management has refused to revise</li> </ul>	Audit Results Report 20 July 2018

# Appendix C

		Our Reporting to you
Required communications	What is reported?	When and where
Auditors report	<ul style="list-style-type: none"> <li>Any circumstances identified that affect the form and content of our auditor's report</li> </ul>	Audit Results Report 20 July 2018
Fee Reporting	<ul style="list-style-type: none"> <li>Breakdown of fee information when the audit planning report is agreed</li> <li>Breakdown of fee information at the completion of the audit</li> <li>Any non-audit work</li> </ul>	Audit planning report February 2018 and Audit Results Report 20 July 2018
Certification work	<ul style="list-style-type: none"> <li>Summary of certification work</li> </ul>	Certification Report - December 2018

# Draft management representation letter

## Draft management Representation Letter

[To be prepared on the entity's letterhead]

[Date]

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

This letter of representations is provided in connection with your audit of the financial statements of Southampton City Council ("the Council") for the year ended 31st March 2018. 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 31st March 2018 and of its income and expenditure for the year then ended in accordance with CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.

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 2015 and CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.
2. We acknowledge, as members of management of the Council, 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, financial performance (or results of operations) and cash flows of the Council in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18. 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. As members of management of the Council, 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 2017/18, that are free from material misstatement, whether due to fraud or error.
5. We believe that the effects of any unadjusted audit differences, summarised in the Audit Results Report, accumulated by you during the current audit and

# Draft management representation letter

## Draft management Representation Letter

pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. We have not corrected these differences identified by and brought to the attention from the auditor because [specify reasons for not correcting misstatement].

### B. Non-compliance with law and regulations, including fraud

1. We acknowledge that we are responsible to determine that the Council's activities are conducted in accordance with laws and regulations and that we are responsible to identify and address any non-compliance with applicable laws and regulations, including fraud.
2. We acknowledge that we are responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud.
3. 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.
4. We have disclosed to you, and provided you full access to information and any internal investigations relating to, all instances of identified or suspected non-compliance with law and regulations, including fraud, known to us that may have affected the Council (regardless of the source or form and including, without limitation, allegations by "whistleblowers") including non-compliance matters:
  - § involving financial statements;
  - § related to laws and regulations that have a direct effect on the determination of material amounts and disclosures in the Council's financial statements;
  - § related to laws and regulations that have an indirect effect on amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operations of the Council's activities, its ability to continue to operate, or to avoid material penalties;
  - § involving management, or employees who have significant roles in internal controls, or others; or
  - § in relation to any allegations of fraud, suspected fraud or other non-compliance with laws and regulations communicated by employees, former employees, analysts, regulators or others.

### C. 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;
  - § 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, Cabinet and Governance Committee (or summaries of actions of recent meetings for which minutes have not yet been prepared) held through to the most recent meeting.
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 period end. These transactions have been appropriately accounted for and disclosed in the financial statements.
5. We believe that the significant assumptions we used in making accounting estimates, including those measured at fair value, are reasonable.
6. 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.

# Draft management representation letter

## Draft management Representation Letter

### D. 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 in Notes 21 and 35 to the financial statements all guarantees that we have given to third parties.

### E. Subsequent Events

1. Other than the matters described in Note 7 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.

### F. Other information

1. We acknowledge our responsibility for the preparation of the other information. The other information comprises: the preface, the Narrative Statement, the Statement of Responsibilities, the Glossary and the Annual Governance Statement.
2. We confirm that the content contained within the other information is consistent with the financial statements.

### H. Prior period adjustments

1. Comparative amounts have been restated in Note 31.a), being the future minimum lease payments under operating leases. They have been restated following a review of the accounts preparation process.
2. The comparative amounts have been correctly restated to reflect the above matter and an appropriate note disclosing this restatement has also been included in the current year's financial statements.
3. There have been no significant errors or misstatements, or changes in accounting policies, other than the matters described above, that would require a restatement of the comparative amounts in the current year's financial statements.

### I. Use of the Work of a Specialist

1. We agree with the findings of the specialists that we engaged to evaluate the valuation of:
  - § property, plant and equipment;
  - § investment properties; and
  - § the defined benefit pension liability.

We have adequately considered the qualifications of the specialists 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 specialists 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 specialists.

## Draft management representation letter

### Draft management Representation Letter

#### J. Estimates

Valuation of property, plant and equipment, investment properties and PFI (and similar arrangements)

1. We believe that the measurement processes, including related assumptions and models, used to determine the accounting estimates have been consistently applied and are appropriate in the context of the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.
2. We confirm that the disclosures made in the financial statements with respect to the accounting estimates are complete and made in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.
3. We confirm that no adjustments are required to the accounting estimate(s) and disclosures in the financial statements due to subsequent events.

#### K. 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.

Yours faithfully,

\_\_\_\_\_  
(Service Director of Finance and Commercialisation)

\_\_\_\_\_  
(Chairman of the Governance Committee)

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