

# Southampton City Council

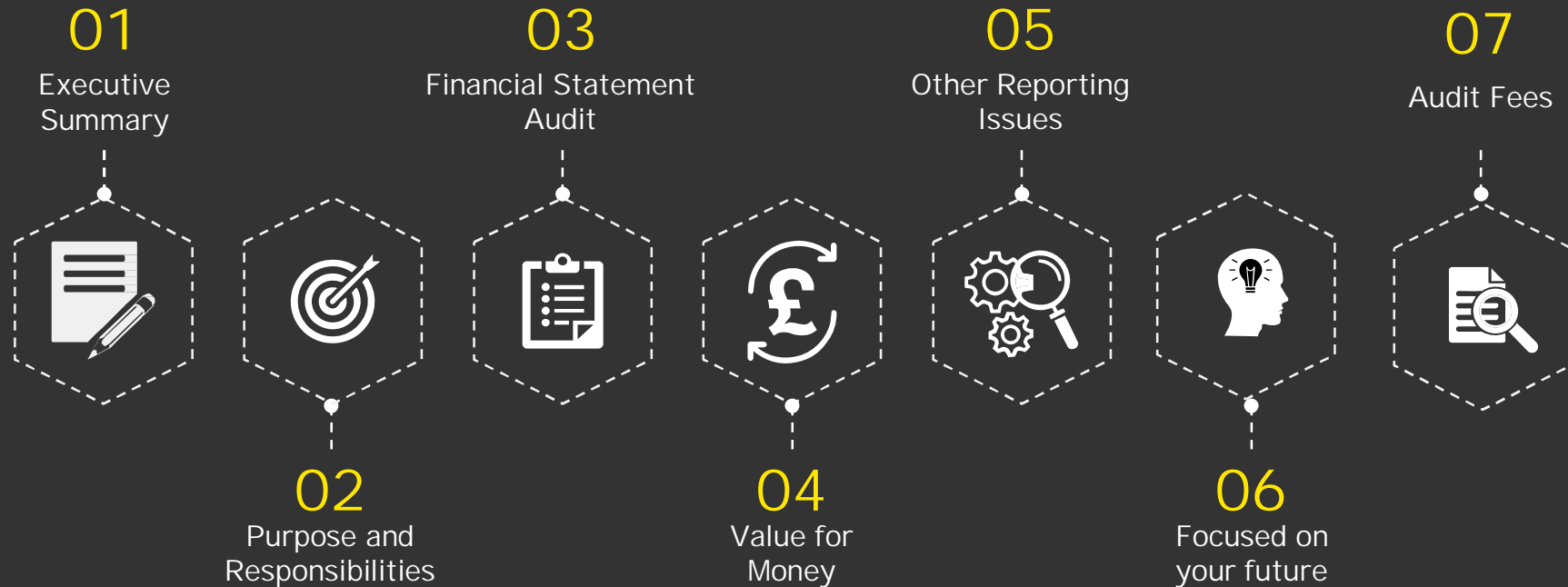
Annual Audit Letter for the year  
ended 31 March 2018

August 2018

The EY logo consists of the letters 'EY' in a bold, white, sans-serif font. A yellow triangle is positioned above the 'Y', pointing downwards towards the letters.

Building a better  
working world

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Public Sector Audit Appointments Ltd (PSAA) have issued a 'Statement of responsibilities of auditors and audited bodies'. It is available from the Chief Executive of each audited body and via the PSAA website ([www.psa.co.uk](http://www.psa.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 23 February 2017)' issued by 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 statute, and covers matters of practice and procedure which are of a recurring nature.

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

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



# 01 Executive Summary

# Executive Summary

We are required to issue an annual audit letter to Southampton City Council following completion of our audit procedures for the year ended 31 March 2018. Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's:	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2018 and of its expenditure and income for the year then ended.
▶ Financial statements	
▶ Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	<p>We had the following matters to report about your arrangements to secure economy efficiency and effectiveness in your use of resources.</p> <p>Our review of the Council's arrangements found the Council has an appropriate procurement and contracting framework. 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.</p> <p>We issued 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.</p>

Area of Work	Conclusion
Reports by exception:	
▶ Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council.
▶ Public interest report	We had no matters to report in the public interest.
▶ Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.

## Executive Summary (cont'd)

Area of Work	Conclusion
<p>Reports by exception (continued):</p> <ul style="list-style-type: none"><li>▶ Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014</li></ul>	<p>We did not receive a valid objection to the 2017/18 accounts from the public. However, we make the following observation.</p> <p>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:</p> <ul style="list-style-type: none"><li>• received follow up questions on 15 June 2018 and they could not turnaround responses to these in time; and</li><li>• needed to consider the commercial sensitivity of some requests.</li></ul> <p>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.</p> <p>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.</p>

Area of Work	Conclusion
<p>Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).</p>	<p>The work necessary to issue our assurance statement in respect of the Council's Whole of Government Accounts consolidation pack is ongoing. The deadline for completion of this work is 31 August 2018.</p>



## Executive Summary (cont'd)

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As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 20 July 2018.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	We have not as yet issued our audit completion certificate. 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 Council'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.

In November 2018 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken.

We would like to take this opportunity to thank the Council's staff for their assistance during the course of our work.



Helen Thompson

Associate Partner

For and on behalf of Ernst & Young LLP



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## Purpose and Responsibilities

# Purpose and Responsibilities

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## The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2017/18 Audit Results Report to the July 2018 Governance Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

## Responsibilities of the Appointed Auditor

Our 2017/18 audit work has been undertaken in accordance with the Audit Plan that we issued in February 2018 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
  - ▶ On the 2017/18 financial statements; and
  - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- ▶ Reporting by exception:
  - ▶ If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - ▶ Any significant matters that are in the public interest;
  - ▶ Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - ▶ If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

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

## Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement. In the Annual Governance Statement, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.





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## Financial Statement Audit

# Financial Statement Audit

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## Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health. We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 31 July 2018. Our detailed findings were reported to the July 2018 Governance Committee.

The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
<p>Misstatements due to fraud or error</p> <p>The financial statements as a whole are not free of material misstatements whether caused by fraud or error.</p> <p>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.</p>	<p>We have not identified any material weaknesses in controls or evidence of material management override.</p> <p>We have not identified any instances of inappropriate judgements being applied.</p> <p>We did not identify any other transactions during our audit which appeared unusual or outside the Council's normal course of business</p>

Significant Risk	Conclusion
<p>Risk of fraud in revenue and expenditure recognition</p> <p>Auditing standards also required us to presume that there is a risk that revenue and expenditure may be misstated due to improper recognition or manipulation.</p> <p>We respond to this risk by reviewing and testing areas of risk which we assessed to be contract guarantees.</p>	<p>Our testing has not identified any material misstatements from revenue and expenditure recognition.</p> <p>Overall our audit work did not identify any material issues or unusual transactions to indicate any misreporting of the Council's financial position.</p>

# Financial Statement Audit (cont'd)

Other areas of audit focus	Conclusion
Property, Plant and Equipment Valuation	<p>With the exception of one finding, our work on this estimate concluded that the methodology and assumptions used by the Council gave rise to materially accurate estimates of property values.</p> <p>Our only finding was that Studio 144 was incorrectly classified as an Investment Property when it should have been classified as Property, Plant and Equipment (PPE). This reclassification to PPE meant that Studio 144 had to be revalued on a different basis. The revised valuation is based on the replacement cost of the asset rather than the income stream it generates. This increased the asset valuation from £0.3m to £30.4m. The Council amended the financial statements to correct this issue.</p>
Pension Liability Valuation	<p>Our work on this estimate concluded that the methodology and assumptions used by the Council give rise to a materially accurate estimate of the pension liability.</p> <p>Our work identified one matter that we reported. For timing reasons, the actuary estimates the value of the pension fund assets at 31 March 2018. This estimate was approximately £31 million lower than the actual pension fund assets held at 31 March 2018. Southampton City Council's share of this variance was £3.7m, meaning that the pension liability was overstated by this value. We agreed with management's assessment not to adjust the accounts on the basis that this matter was not material.</p>
Private Finance Initiative (PFI) accounting	<p>Our work on this estimate concluded that the methodology and assumptions used by the Council give rise to a materially accurate accounting entries</p> <p>Our work identified two matters that we reported relating to PFI Schools and PFI Street Lighting. These matters were of a technical accounting nature and neither impacted the Council's General Fund balance or any other measure of the Council's financial viability.</p>

## Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
Planning materiality	<p>We determined planning materiality to be £13.3 million (2016/17: £12.6 million), which is 2% of gross revenue expenditure reported in the accounts.</p> <p>We consider gross revenue expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p>
Reporting threshold	<p>We agreed with the Governance Committee that we would report to the Committee all audit differences in excess of £0.64 million (2016/17: £0.63 million)</p>





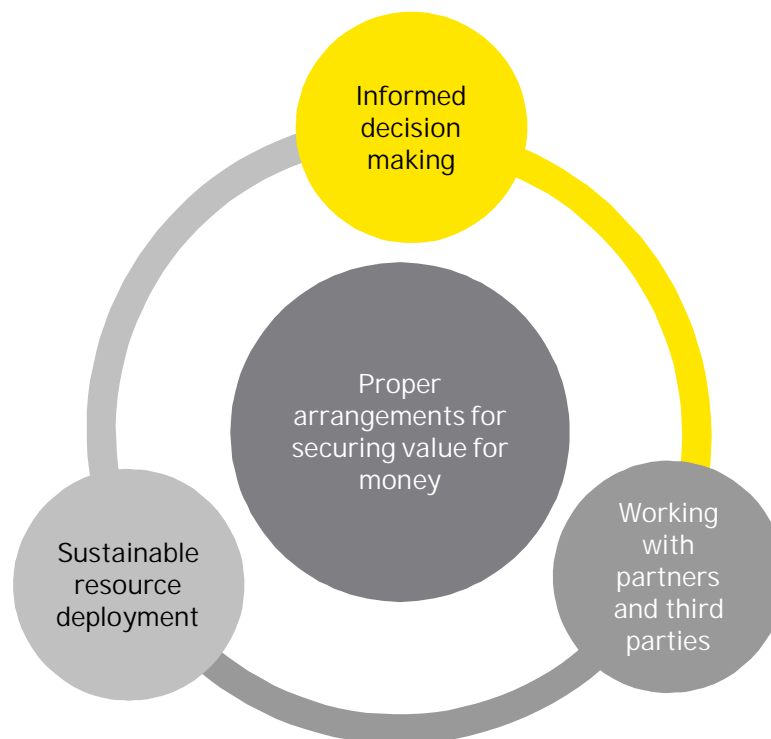
# 04 Value for Money

# £ Value for Money

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.

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.



We identified two significant risks relating to these arrangements.

In relation to these risks, we had the following matters to report about the Council's arrangements to secure economy, efficiency and effectiveness in its use of resources:

- we were satisfied that 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 place. However, there was non-compliance with this framework, with the most significant issues being caused by staff failing to engage with the central procurement team. This included 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 concluded 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 issued an 'except for' conclusion: we were satisfied with the Council's 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.





## 05 Other Reporting Issues



## Other Reporting Issues

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### Whole of Government Accounts

The work necessary to issue our assurance statement in respect of the Council's Whole of Government Accounts consolidation pack is ongoing. The deadline for completion of this work is 31 August 2018.

### Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

### Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

### Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

## Other Reporting Issues (cont'd)

### Objections Received

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.

### Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

### Independence

We communicated our assessment of independence in our Audit Results Report to the Governance Committee on 30 July 2018. 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 regulatory and professional requirements.

### Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

We have adopted a fully substantive approach and have therefore not specifically tested the operation of controls.

Our audit did not identify any controls issues to bring to the attention of the Governance Committee.



06

Focused on your future





## Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Council is summarised in the table below.

Standard	Issue	Impact
IFRS 9 Financial Instruments	<p>Applicable for local authority accounts from the 2018/19 financial year and will change:</p> <ul style="list-style-type: none"> <li>• How financial assets are classified and measured;</li> <li>• How the impairment of financial assets are calculated; and</li> <li>• The disclosure requirements for financial assets.</li> </ul> <p>There are transitional arrangements within the standard and the 2018/19 Accounting Code of Practice for Local Authorities has now been issued, providing guidance on the application of IFRS 9. In advance of the Guidance Notes being issued, CIPFA have issued some provisional information providing detail on the impact on local authority accounting of IFRS 9, however the key outstanding issue is whether any accounting statutory overrides will be introduced to mitigate any impact.</p>	<p>Although the Code has now been issued, providing guidance on the application of the standard, along with other provisional information issued by CIPFA on the approach to adopting IFRS 9, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty. However, what is clear is that the Council will have to:</p> <ul style="list-style-type: none"> <li>• Reclassify existing financial instrument assets</li> <li>• Re-measure and recalculate potential impairments of those assets; and</li> <li>• Prepare additional disclosure notes for material items.</li> </ul>
IFRS 15 Revenue from Contracts with Customers	<p>Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except:</p> <ul style="list-style-type: none"> <li>• Leases;</li> <li>• Financial instruments;</li> <li>• Insurance contracts; and</li> <li>• For local authorities; Council Tax and NDR income.</li> </ul> <p>The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations.</p>	<p>As with IFRS 9, some provisional information on the approach to adopting IFRS 15 has been issued by CIPFA in advance of the Guidance Notes. Now that the Code has been issued, initial views have been confirmed; that due to the revenue streams of Local Authorities the impact of this standard is likely to be limited.</p> <p>The standard is far more likely to impact on Local Authority Trading Companies who will have material revenue streams arising from contracts with customers. The Council will need to consider the impact of this on their own group accounts should a trading company be consolidated.</p>





## Focused on your future (cont'd)

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Standard	Issue	Impact
IFRS 16 Leases	<p>It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2019/20 financial year.</p> <p>Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet.</p> <p>There are transitional arrangements within the standard and although the 2019/20 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.</p>	<p>Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area.</p> <p>However, what is clear is that the Council will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented.</p>

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A close-up photograph of a person's hand sorting through several hanging file folders. The folders are filled with papers, and the hand is reaching into one of them. The background is a textured wall.

## 07 Audit Fees

## Audit Fees

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 2017/18	Scale Fee 2017/18	Final Fee 2016/17
	£	£	£	£
Total Audit Fee – Code work	154,557*	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 agreed with the Service Director of Finance and Commercialisation (s151 officer). 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.

\*\* 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.

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EY-000070901-01 (UK) 07/18. CSG London.



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