

# Annual Audit Letter

Southampton City Council

Audit 2010/11



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# Key messages

**This report summarises the findings from my 2010/11 audit. My audit comprises two parts:**

- **the audit of your financial statements; and**
- **my assessment of your arrangements to achieve value for money in your use of resources.**

Parts of the audit	My findings
Unqualified audit opinion	✓
Proper arrangements to secure value for money	✓

## **Audit opinion and financial statements**

I issued an unqualified opinion on the Council's financial statements on 28 September 2011.

The Council prepared its accounts against a background of the transition to IFRS accounting. As a result, officers were under greater pressure than in previous years. Despite this extra work your financial statements and supporting working papers were produced in line with agreed timetables and to a good standard.

## **Value for money**

I issued an unqualified VFM Conclusion on 28 September 2011.

It has been another challenging year for the Council, in which you have responded positively to the challenge of continuing financial pressures and maintained your focus on delivering efficient and effective services. My work in support of this conclusion showed the Council has used its effective budget setting and budgetary control arrangements to:

- manage its finances and to maintain reserves above the predetermined minimum level of £4.5 million;
- set out its medium term financial plan, identifying an initial £54.3 million funding shortfall over the three years to 2014/15. £16.4 million of this has so far been identified through efficiencies, savings, additional income and changes to the redundancy scheme; and
- outline plans for future savings amount to £9.9 million, leaving a remaining shortfall of £28 million.

You have also implemented a number of key strategic partnerships and delivered Phase 1 of your Estates Regeneration programme which are designed to improve still further your use of resources.

# Current and future challenges

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The government is continuing its policy of cutting public spending and the impact of this will continue to dominate the Council's agenda. Having based its 2011/12 budget on achieving £17.9 million of savings and drawing on reserves, the Council has identified the need to find another £54.3 million of savings over the next three years to keep its finances in balance. An initial savings programme has been established by the Council and reported to Cabinet in October 2011 but Members will need to address the remaining shortfall through the budget setting process. The continuing economic downturn is likely to mean greater pressure on income streams and an increase in the demand for the Council's services.

The main challenges for the Council over the next twelve months include:

- restructuring of the Council's workforce to improve the efficient working of the Council and reduce the number of senior management posts;
- the delivery of the estates regeneration programme phases 2 and 3; and
- joint commissioning with the Primary Care Trust for the commissioning of Adult Health and Social Care.

Other challenges the Council will face over the next few years, include:

- changes proposed in the government's Welfare Reform Bill, including new arrangements for housing and council tax benefits;
- changes proposed in the government's Localism bill, including new arrangements for funding social housing and for enabling local groups to take over community facilities and services; and
- government proposals to allow local authorities to retain business rates.

My work for the 2011/12 VFM conclusion will take account of how the Council is responding to these challenges.

# Financial statements and annual governance statement

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**The Council's financial statements and annual governance statement are an important means by which the Council accounts for its stewardship of public funds.**

## **Overall conclusion from the audit**

I issued an audit report including an unqualified opinion on the Council's financial statements on 28 September 2011. The Council completed the statements in line with the required timetable, even though they needed to comply with IFRS for the first time which put extra pressure on your staff. Despite this extra pressure your financial statements and supporting working papers were once again produced to a good standard.

Having recently issued my decision on an objection to your 2009/10 accounts about how the Council calculates heating charges to tenants and leaseholders, I have now certified completion of both the 2009/10 and 2010/11 audits.

## **Significant issues arising from the audit**

The draft accounts presented for audit contained four errors above my materiality level of £13.5 million. There were seven other errors above £135k that I reported to the Standards and Governance Committee. All of these errors were corrected before I gave my opinion on the financial statements. None had any impact on the Council's reported net under spending for the year of £4.7 million.

I reported one other matter to the Standards and Governance Committee which was not material to my opinion. I disagreed with officers' interpretation of the disclosure required by Financial Reporting Standard 12 (Provisions, contingent liabilities and contingent assets) for the equal pay provision. My interpretation is the equal pay provision should have been recognised in the financial statements. While the provision was included in the Council's ledger it was not recognised in the financial statements. The Council chose not to disclose the information usually required to be shown within Statement of Accounts. The Monitoring Officer advised that to disclose the information would seriously prejudice the Council's position in ongoing litigation. The Council included this explanation in the financial statements. Members supported officers' decision and I accepted the explanations provided in the letter of representation.

I reviewed your Annual Governance Statement and confirmed it complied with CIPFA guidance and the content was consistent with my knowledge of the Council.

## **Significant weaknesses in internal control**

The Council has a sound system of internal control. I have not identified any new significant weaknesses in internal controls that I need to bring to your attention arising from my 2010/11 audit.

## **Heating charges**

Members will be aware that local government electors continue to raise queries with me over the way it operates the heating charges account. I have monitored the Council's progress in making the improvements in internal control I suggested in my 2009/10 annual audit letter. I have also considered further concerns raised with me by an elector during the year.

In my 2009/10 Annual Audit Letter, I urged the Council to:

- Review the accuracy of its database of electricity meters;
- Correct its accounts where any errors are identified;
- Set up a more effective database and system of controls; and
- Review the record of gas meters to discover if there are similar weaknesses in these records.

## **Accuracy of meter database**

The Council has followed up on all the meters where the designation between heating and lighting was unconfirmed. In most cases the database has been confirmed as correct. In 32 cases the meter designations were incorrect and have now been amended. 40 meters on the database are still being investigated. The majority are being discussed with the suppliers to establish whether a refund is due for overcharged costs. Four are to be removed from the database, and the remainder still have their designation to be confirmed.

## **Correction of accounts**

The Council has calculated the financial adjustments necessary for the 32 errors in the meter database and adjusted its accounts. The Council has also investigated some other errors identified by the elector and made appropriate amendments in its accounts where invoices were not allocated in accordance with the database of meters; where clerical errors resulted in incorrect allocation of invoices; and where heating charges for communal areas were incorrectly allocated.

### **Set up a more effective database and system of controls**

The Council has implemented a new computer based meter record (System link) that is being evaluated through parallel running with the old meter record.

### **Gas meters**

Gas meter designations are being confirmed as part of the annual gas servicing cycle.

### **Conclusion**

The Council agreed to complete the work necessary to check the data on its meters and make any necessary financial adjustments to its accounts by December 2010. While it has taken longer than planned to do this, I am satisfied that progress is being made. The financial errors identified are not material to my opinion on the Council's financial statements. I have now certified completion of the 2009/10 and 2010/11 audits. I am grateful for the significant amount of work that Internal Audit has undertaken on my behalf which has minimised the cost of completing this work. In the current year I will continue to monitor the Council's progress in:

- Confirming the accuracy of its meter database;
- Correcting its accounts for any more errors identified; and
- Evaluating the effectiveness of the new "System link" meter record

# Value for money

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**I considered whether the Council is managing and using its money, time and people to deliver value for money. I assessed your performance against the two criteria specified by the Audit Commission and have reported the outcome as the value for money (VFM) conclusion.**

The Council is addressing the weaknesses I have highlighted in previous years, although it still has more to do, particularly in closing the budget gap in its Medium Term Forecast. Even so, the Council's record of strong financial management and continuing improvement in performance in recent years gives me confidence that it will continue to address these issues. My overall conclusion is the Council has put in place proper arrangements to secure, economy, efficiency and effectiveness in its use of resources.

## **How I formed my value for money conclusion:**

To form my view on the Council's arrangements, I planned a programme of VFM audit work based on my risk assessment. This included:

- capturing what I knew already from last year's work, the Audit Commission's VFM profiles, my continuing reviews of minutes and discussions with officers;
- considering how the Council is addressing issues I raised in my Annual Audit Letter last year, on the Council's progress with its savings plans, joint working with other public bodies, achievement of planned benefits from strategic contracts and the affordability of the planned capital programme; and
- considering risks that are common to some or all local authorities, including
  - the government's spending review;
  - preserving essential services and effectiveness with reduced funding;
  - the new public services transparency requirements; and
  - sector self-regulation and improvement.

## **My findings**

I set out below my conclusions on each specified criterion.



## Financial resilience

The Council has a track record of strong financial management, using its key priorities to drive the budget setting process. Effective budgetary control arrangements have enabled the Council to respond to planned and unexpected demands on resources and to maintain a prudent level of reserves. The Council responded promptly and decisively to the reduction in government funding, reviewing directorate plans and budgets to identify savings while seeking to maintain the level and standard of services.

Further key changes have been made for 2011/12 to address the financial pressures and worsening economic outlook. These include restructuring the Council and implementing changes to staff terms and conditions.

The organisational review is restructuring the Council into three core front line directorates, supported by a central core. The review is designed to improve the efficient working of the Council and the original estimate for savings is £1.5 million through the reduction of senior management posts and personal assistants /business support. The first phase of the restructure established a new 'Management Board of Directors' in April 2011. The number of directorates was reduced to 5, reducing the number of directors that are in post. There will be a further reduction by 2013 when the Children's Services and Learning Directorate will merge with the Health and Adult Social Care Directorate to form a new Families and Communities Directorate. The phase 2 consultation process ended in September 2011 and the appointment and appeals process will be concluded before the new structure is implemented in November 2011.

Changes have also been made to staff terms and conditions in 2011/12 to realise more than £5million in recurring savings. There was however a delay in implementation of the changes until 11 July 2011 which resulted in a £1.3 million reduction in planned savings in 2011/12. This shortfall is being met through other one-off sources.

Directorate savings plans for 2011/12 also include a significant number of redundancies. This level of redundancy might reduce the Council's capacity to effectively manage the delivery its services. In order to ensure that its current financial resilience is maintained, the Council will need to be alert to the emergence of potential financial risks from reduced staff capacity in key areas.

The Council has prepared a draft budget proposal for 2012/13 and a Medium Term Forecast up until 2014/15. These proposals were presented to Cabinet in October 2011 and will be used for the budget consultation process. The results of the consultation will be reported together with the Executive's final budget proposals in February 2012. The current plans have highlighted a cumulative shortfall in funding of £1.5 million in 2012/13 after the delivery of proposals for efficiencies totalling £9.1 million, additional income £0.8 million and service reductions £2.8 million. This £1.5 million budget gap in 2012/13 rises cumulatively in the Medium Term Forecast to £28 million by 2014/15.

There is still some way to go before the Council can be confident about the delivery of its savings programme. The October 2011 Cabinet report confirms that members will continue to explore opportunities for further savings and efficiencies during the budget setting process. This will include further developing initial 'future savings options' that have been included in the Medium Term Forecast that rise from £8.2 million in 2013/14 to more than £12 million in 2014/15.

I am satisfied that appropriate action is being taken to address the funding gap that has been identified through the Council's Medium Term Forecast.

## Securing economy efficiency and effectiveness

Based on my previous years' work, there were three main areas where I judged that failure to take action could put at risk the Council's achievement of good value for money. These were the outsourcing of services through partnerships, estates regeneration and seeking more efficient ways of working in collaboration with the Primary Care Trust.

### Partnerships

My work this year shows there have been significant developments through working with 'private sector partners' and that there were no issues arising from my work that impacted on my value for money conclusion. Key partnerships that have been implemented include the Highways Strategic Partnership; Street Lighting and Sport and Recreation.

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Table 1: **Developing Partnerships in 2010/11**

The Council has implemented some key partnerships during 2010/11

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<b>Partnership</b>	<b>Findings</b>
Highways strategic partnership	<p>Robust governance arrangements have been put in place to manage this contract through the Strategic Management Board. A review of these arrangements has been carried out in 2011/12 by Internal Audit and action is being taken by management to implement their recommendations for improvement.</p> <p>The benefits of the contract that have been realised in the first year of the contract have been assessed and reported by the Client Side Team. This recognised that while many of the benefits that were anticipated are being realised, there is still a lot to do in order to continue to improve the highways network and achieve the longer term benefits of the Partnership.</p>
Street Lighting PFI	<p>The Council has developed procedure notes and performance management arrangements to ensure that the contract is adequately managed. Risk management for the project is operated through the risk register which uses risk ratings to determine priorities.</p> <p>A benefits realisation report has been prepared and this demonstrates the Partnership's performance in its first year of operation, and anticipates further improvements as the contract progresses.</p>

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Partnership	Findings
Sport and Recreation	Senior management is to review the staffing of the client side team to ensure it has sufficient capacity to manage the contract.  The Council has contracted with Active Nation and DC Leisure for the management of its Municipal Golf Course and Leisure facilities. The procurement process met OJEU requirements and involved competitive discussions with bidders

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### **Estates regeneration**

The Council's estate regeneration programme is a key component in delivering the city wide priority of sustained economic growth. It also contributes to its objective to deliver new homes and additional jobs. The Council has made significant progress through the delivery of its phase 1 £16 million pilot scheme at Hinkler Parade in 2010/11. The first sales of new homes have been made and retailers occupy three of the new retail outlets. The successful implementation of this pilot scheme has given the Council a good basis for planning implementation of the phase 2 schemes.

### **Collaboration with the Primary Care Trust**

The Council and NHS Southampton City (NHSSC) have agreed to transfer the responsibility and funding for all aspects of health and social care for people with learning disabilities to the City Council, combining annual budgets of £62.7 million from the Council with £83 million from NHSSC. This includes specialist social care funding for people with learning disabilities and the social care resources being made available to the Council direct from the Department of Health from April 2011. The Council and NHSSC have put in place robust arrangements to manage the commissioning of Adult Health and Social Care. These arrangements are set out in a formal signed agreement that details the staffing structure and governance arrangements and that has been prepared using powers under Section 75 of the National Health Service Act 2006. The effectiveness of these arrangements will be reviewed by the Council during 2011/12 and I will revisit this area during my 2011/12 audit.

# Closing remarks

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I have discussed and agreed this letter with the Chief Executive, Director of Corporate Services and the Section 151 Officer. The letter will be sent to all members by 30 November 2011. I will present this letter to the Audit Committee and the Standards and Governance Committee at their respective meetings in December 2011.

I set out below, for information, the reports I have issued to the Council during the year.

Report	Date issued
Initial fee plan	April 2010
Certification of grant claims and returns	February 2011
Audit Plan	June 2011
Annual Governance Report (including audit opinion and VFM conclusion)	September 2011

The Council has taken a positive and constructive approach to our audit. I wish to thank the Council staff for their support and cooperation during the audit.

Kate Handy

District Auditor

November 2011

# Appendix 1 - Fees

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	Actual	Proposed	Variance
Audit fee	£350,400	£350,400	£0
<b>Total</b>	<b>£350,400</b>	<b>£350,400</b>	<b>£0</b>

## Fees for electors questions on and objections to the Council's accounts

I have agreed with officers that I will separately invoice the Council for the fee for dealing with correspondence with local electors and objections to the accounts. At the end of October 2011 this amounted to £39,974 of which the Council has already paid £20,166.

# Appendix 2 - Glossary

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## **Annual governance statement**

Governance is about how local government bodies ensure that they are doing the right things, in the right way, for the right people, in a timely, inclusive, open, honest and accountable manner.

It comprises the systems and processes, cultures and values, by which local government bodies are directed and controlled and through which they account to, engage with and where appropriate, lead their communities.

The annual governance statement is a public report by the Council on the extent to which it complies with its own local governance code, including how it has monitored the effectiveness of its governance arrangements in the year, and on any planned changes in the coming period.

## **Audit opinion**

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

## **Opinion**

If I agree that the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view.

### **Value for money conclusion**

The auditor's conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources based on criteria specified by the Audit Commission.

If I find that the audited body had adequate arrangements, I issue an unqualified conclusion. If I find that it did not, I issue a qualified conclusion.

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