

Annual Governance Report

Southampton City Council

Audit 2007/08

Date

DRAFT

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The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors/members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

Summary

Purpose

- 1 This report summarises the findings from our 2007/08 audit, which is still in progress. Details of the areas that we have still to complete are given in appendix 3. We will provide an update to the Standards and Governance Committee on the completion of the audit at its meeting on 25 September 2008. It identifies the key issues that you should consider before we issue our opinion, conclusion and certificate.
- 2 This report includes only matters of governance interest that have come to our attention in performing our audit. Our audit is not designed to identify all matters that might be relevant to you.

Financial statements

- 3 Subject to the completion of the work that is detailed within appendix 3 we expect to issue an unqualified opinion on the financial statements. The audit cannot be concluded and an audit certificate issued until I have completed my consideration of matters that have been brought to my attention by local authority electors relating to heating charges in Council properties.
- 4 The financial statements submitted for audit were complete. Based on the work that we have already completed there are no adjustments that will impact upon the Council's financial position at 31 March 2008.
- 5 There were two significant presentational adjustments that have been corrected within the financial statements that were above our materiality level of £8m. Firstly, the Council had wrongly treated the change in the index factor used to revalue its council dwellings as an amendment to 2006/07 brought forward figures, rather than as a prior period adjustment in 2007/08. Secondly it needed to remove government grants and contributions from the capital adjustment account.
- 6 There was also one presentational adjustment that was above our 'non-trivial' threshold of £500,000 but below materiality, relating to the accounting treatment of revaluations on assets that were disposed of during the year. This has also been amended.
- 7 The arrangements for production of your financial statements are satisfactory and the draft financial statements were produced before the statutory deadline. The working papers produced to support the financial statements were of a good standard.
- 8 We will update the Standards & Governance Committee on the results of our outstanding work at its 25 September 2008 meeting.

- 9 The Council has expended a significant amount of resources addressing the weaknesses that exist within its social care billing process and the PARIS system, which processes income and expenditure associated with social care packages. We are satisfied that any misstatement of the figures reported within the financial statements in relation to social care billing is unlikely to be material. The Council is taking appropriate action to reduce the risks from the weaknesses that have been identified until a replacement charging policy and system can be put in place.

Value for Money

- 10 Our work on the Council's arrangements to secure economy, efficiency and effectiveness in its use of resources is now complete. We propose issuing an unqualified conclusion on the use of resources by the 30 September 2008.

Next steps

- 11 We ask the Standards and Governance Committee to:
- consider the matters raised in this report before approving the financial statements;
 - agree to adjust the financial statements as set out in this report;
 - approve the representation letter on behalf of the Council before we issue our opinion, conclusion and certificate; and
 - agree the proposed action plan.

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Financial statements and Annual Governance Statement

- 12 The Council's financial statements and Annual Governance Statement are important means by which the Council accounts for its stewardship of public funds. As Council members you have final responsibility for the financial statements and Annual Governance Statement. It is therefore important that you consider our findings before you adopt the financial statements and the Annual Governance Statement.
- 13 In planning our audit we identified specific risks and areas of judgement that we have focused on during our audit. We report to you the findings of our work in those areas.
- 14 In addition, auditing standards require us to report to you:
- the draft representation letter which we are asking management and you to sign;
 - our views about the Council's accounting practices and financial reporting;
 - errors in the financial statements;
 - any expected modification to our report;
 - weaknesses in internal control; and
 - certain other matters.

Key areas of judgement and audit risk

- 15 In planning our audit we identified key areas of judgement and audit risk that we have considered as part of our audit. Our findings are set out in Table 1.

Table 1 Key areas of judgement and audit risk

Issue or risk	Finding
Weaknesses in the interface between the social care income system and the financial ledger.	I am satisfied that the income raised during 2007/08 in relation to social care packages and the year end debtor balance, are materially correct within the financial statements.
The benefit and revenues systems were being reconciled to the main accounting system annually rather than monthly	The Council has reconciled its revenues systems to the main accounting system at the year end. The year end reconciliation of the academy system to the main accounting system includes an immaterial reconciling

Issue or risk	Finding
	<p>adjustment in relation the Rent Rebates (£166,000) and Rent Allowances (£212,000).</p> <p>I am satisfied that cash receipts are being reconciled between the revenues systems and the main accounting system on a monthly basis from 1 April 2008. Rent allowance payments are being reconciled on a monthly. basis.</p>
<p>The implementation of the SSP will include the transfer of the operation of some key financial systems to the SSP partner, which could impact upon the production of the accounts.</p>	<p>The transfer of key financial systems to the SSP partner has not impacted upon the process for the production of the 2007/08 accounts.</p>
<p>Changes to the 2007 SORP, including for example the revaluation reserve and capital adjustment account, and financial instruments.</p>	<p>The requirements of the 2007 SORP have been implemented, although the capital adjustment account has been amended to remove capital grants and contributions and to include the revaluations in respect of assets that were disposed of during the year.</p>
<p>The transfer of IT assets and the retention of FRS17 liabilities for staff transferred under the SSP contract.</p>	<p>The Council has correctly accounted for these items within its financial statements for 2007/08.</p>

Draft representation letter

16 Before we issue our opinion, auditing standards require us to obtain from you and management, written representations that:

- you acknowledge your collective responsibility for preparing financial statements in accordance with the applicable financial reporting framework;
- you have approved the financial statements;
- you acknowledge your responsibility for the design and implementation of internal controls to prevent and detect fraud and error;
- you have told me the results of your assessment of the risk that the financial statements might be materially misstated because of fraud;

Financial statements and Annual Governance Statement

- you have told me any actual or suspected fraud by management, employees with significant roles in internal control or others (where the fraud could have a material impact on the financial statements);
- you have told me of any allegations of fraud, or suspected fraud, affecting the financial statements communicated by employees, former employees, regulators or others;
- you have told me about all known actual or possible non-compliance with laws and regulations whose effects should be considered when preparing financial statements;
- you have assessed the reasonableness of significant assumptions, including whether they appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the Council where relevant to the fair value measurements or disclosures;
- you are satisfied that all related parties requiring disclosure in the financial statements have been disclosed and that the disclosure is adequate;
- you are satisfied that the individual or collective impact of errors we have identified, but that you have not corrected, is not material; and
- cover areas where other sufficient appropriate evidence cannot reasonably be expected to exist, for example the completeness of the disclosure of contingent liabilities.

17 Appendix 1 contains the draft of the letter of representation we seek from you.

Accounting policies and financial reporting

18 We consider the qualitative aspects of your financial reporting. Table 2 contains the issues we want to raise with you.

Table 2 Accounting practice and financial reporting

Issue or risk	Finding
<p>I have received correspondence from local authority electors in respect of the recharges that the Council has made for heating during 2007/08.</p>	<p>The Council has accounted for these costs and the recharges to tenants within its financial statements for 2007/08.</p> <p>I am satisfied that the Council has considered its options in respect of the installation of sub meters within council properties, and for the implementation of an interim charging policy.</p> <p>However until I have completed my review of the matters that have been brought to my attention by electors, the audit cannot be formally concluded and an audit</p>

Issue or risk	Finding
	certificate issued.

Errors in the financial statements

- 19 Based on the work that we have already completed there are no adjustments that will impact upon the Council's financial position at 31 March 2008. Officers have, however, amended the financial statements in respect of the following significant presentational adjustments. The first two are above our materiality level for opinion purposes of £8m, while the third is below this level but above our 'non-trivial' threshold, i.e.£500,000:
- the change in index factor used for the revaluation of council dwellings, to the Southampton specific factor, is now shown as a prior period adjustment within the 2007/08 financial statements, instead of adjusting the 2006/07 comparative figures (£16.4m);
 - government grants and contributions have been removed from the capital adjustment account, totalling £10.3m; and
 - revaluations in relation to fixed assets that have been disposed of during the year have been transferred to the capital adjustment account from the revaluation reserve (£3.4m).
- 20 These presentational amendments have no effect on the Council's overall financial position. We have not identified any other errors within the work that has been completed (other than those of a trivial nature) that management has declined to correct. We will update the Standards and Governance Committee on the completion of the audit at its meeting on 25 September 2008.

The audit report

- 21 We plan to issue a modified report including an unqualified opinion on the financial statements. Appendix 2 contains a copy of our draft report. The audit cannot be formally concluded and an audit certificate issued until I have completed my consideration of matters brought to my attention by local authority electors.

Material weaknesses in internal control

- 22 We have identified weaknesses in the design or operation of an internal control that might result in a material error in your financial statements which has not been reported to you. These weaknesses are set out in Table 3.

Table 3 Weaknesses in internal control

Issue or risk	Finding
<p>The application of the Council's social care billing policy and operation of the 'PARIS' charging system have continued to cause significant system processing difficulties for the Council during 2007/08.</p> <p>The Council has therefore carried out detailed work to ensure that charges are correctly billed during the year and that the debtors balance at the financial year end is materially correct within its financial statements.</p>	<p>Testing has confirmed that social care income has been fairly stated within the financial statements and that the year end debtors balance is materially correct.</p> <p>The planned implementation of a revised charging policy from 1 April 2009 should simplify the charging process and mitigate this risk.</p>

Recommendation
<p>R1 The Council should:</p> <ul style="list-style-type: none"> • continue to ensure that social care charges are correctly raised and accounted for during 2008/09; and • prepare and implement the planned replacement social care charging policy during 2009/10.

23 We have not provided a comprehensive statement of all weaknesses which may exist in internal control, nor of all improvements which may be made. We have reported only those matters which have come to our attention because of the audit procedures we have performed.

Other matters

24 There are no other matters that auditing standards require me to report to you.

Value for money

- 25 We are required to conclude whether the Council put in place adequate corporate arrangements for securing economy, efficiency and effectiveness in its use of resources. We assess your arrangements against the 12 criteria specified by the Commission. Our conclusion is informed by our work on Use of Resources, a scored judgement reported to the Audit Commission.
- 26 We have assessed the arrangements of the Council as adequate in each of the areas specified by the Audit Commission and we therefore propose to issue an unqualified conclusion.

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Formal audit powers

27 We have:

- a power to issue a public interest report. We do so where we believe this is necessary to draw a matter to your attention, or to that of the public;
- a power to apply to court for a declaration that an item in the Council's accounts is contrary to law;
- a power to issue an advisory notice. An advisory notice requires the Council to meet and consider the notice before:
 - making a decision that might give rise to unlawful expenditure; or
 - taking an unlawful course of action that would give rise to a loss; or
 - making unlawful entry in the accounts; and
- a power to seek judicial review of a decision of the Council.

28 I am currently reviewing matters that have been brought to my attention by electors relating to heating charges in Council properties. When I have completed this review I will be able to conclude whether I need to consider exercising these powers.

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Independence

- 29 The Code of Audit Practice and the APB's Ethical Standards with which auditors must comply require that auditors act, and are seen to act, with integrity, objectivity and independence.
- 30 We confirm that we comply with the APB's Ethical Standards, that we are independent and that our objectivity is not compromised.
- 31 We communicate to you:
- any relationships between us and the Council, its members and senior management that might affect our objectivity and independence and any safeguards put in place;
 - total fees charged to you for audit and non-audit services; and
 - our arrangements to ensure independence and objectivity.

Relationships with the Council

- 32 We have identified no relationships that might affect objectivity and independence.

Audit fees

- 33 We reported our fee proposals as part of the Audit Plan for 2007/08. The table below reports the anticipated outturn fee against that plan.

Table 4 **Audit fees**

	Plan 2007/08	Anticipated actual 2007/08
Financial statements and Annual Governance Statement	179,300	179,300
Value for Money	73,500	73,500
Data Quality	20,800	20,800
Whole of government accounts	1,550	1,550
National Fraud Initiative	1,050	1,050
Total Audit Fees	276,200	276,200
Other work	450	450

Independence

- 34 The analysis above shows that we anticipate that our audit fee will remain within the totals you have already agreed. This is however dependent upon the completion of the audit work that remains outstanding and the resolution of the matters that have been brought to my attention by local authority electors, in respect of heating charges.
- 35 Under the Audit Commission's advice and assistance power it may provide non-audit services to the Council. We have submitted and agreed written proposals to carry out advice and assistance work in relation to:
- The highways futures project. We are to review the Council's business case and associated assessments of financial, legal and operational risks and provide external challenge to the development of the approach to OJEU procurement. The fee that has been agreed for this work amounts to £13,000.
 - A review of partnership protocols to support the improvement of the Council's strategic approach to partnership working. We have agreed a fee of £7,500 for this work.

Our arrangements to ensure independence and objectivity

- 36 We have comprehensive procedures to ensure independence and objectivity. These are outlined in Table 5.

Table 5 Arrangements to ensure independence and objectivity

Area	Arrangements
Independence policies	<p>Our policies and procedures ensure that professional staff or an immediate family member:</p> <ul style="list-style-type: none">• do not hold a financial interest in any of our audit clients;• may not work on assignments if they have a financial interest in the client or a party to the transaction or if they have a beneficial interest in a trust holding a financial position in the client; and• may not enter into business relationships with UK audit clients or their affiliates. <p>Our procedures also cover the following topics and can be provided to you on request:</p> <ul style="list-style-type: none">• the general requirement to carry out work independently and objectively;• safeguarding against potential conflicts of interest;• acceptance of additional (non-audit) work;• rotation of key staff;• other links with audited bodies;• secondments;• membership of audited bodies;

Area	Arrangements
	<ul style="list-style-type: none"> • employment by audited bodies; • political activity; and • gifts and hospitality.
Code of Conduct	The Code of Conduct forms part of the terms and conditions of all Audit Commission employees. The Code of Conduct states that staff have to comply with ethical guidance issued by their relevant professional bodies.
Confidentiality	All staff are required to sign an annual undertaking of confidentiality as a condition of employment.

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Appendix 1 – Letter of representation

To: Kate Handy
District Auditor
Audit Commission
Collins House
Bishopstoke Road
Eastleigh
Hampshire.
SO50 6AD

Southampton City Council - Audit for the year ended 31 March 2008.

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other relevant directors, of Southampton City Council, the following representations given to you in connection with your audit of the Council's financial statements for the year ended 31 March 2008. All representations cover the Council's accounts included within the financial statements.

Compliance with the statutory authorities

I acknowledge my responsibility under the relevant statutory authorities for preparing the financial statements in accordance with the Code of Practice for Local Authority Accounting in the United Kingdom: A Statement of Recommended Practice which present fairly the financial position and financial performance of the Council and for making accurate representations to you.

Supporting records

All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the Council have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of all Council and Committee meetings, have been made available to you.

Irregularities

I acknowledge my responsibility for the design and implementation of internal control systems to prevent and detect fraud or error.

There have been no:

- irregularities involving management or employees who have significant roles in the system of internal accounting control;
- irregularities involving other employees that could have a material effect on the financial statements; or

- communications from regulatory agencies concerning non-compliance with, or deficiencies on, financial reporting practices which could have a material effect on the financial statements.

I also confirm that I have disclosed:

- my knowledge of fraud, or suspected fraud, involving either management, employees who have significant roles in internal control or others where fraud could have a material effect on the financial statements; and
- my knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

Law, regulations, contractual arrangements and codes of practice

There are no instances of non-compliance with laws, regulations and codes of practice, likely to have a significant effect on the finances or operations of the Council.

The Council has complied with all aspects of contractual arrangements that could have a material effect on the financial statements in the event of non-compliance. There has been no non-compliance with requirements of regulatory authorities that could have a material effect on the financial statements in the event of non-compliance.

Fair Values

I confirm the reasonableness of the significant assumptions within the financial statements. For these assumptions, I confirm:

- the appropriateness of the measurement method;
- the basis used by management to overcome the presumption under the financial reporting framework;
- the completeness and appropriateness under the financial reporting framework; and
- if subsequent events require adjustment to the fair value measurement they will be actioned.

Assets

The following have been properly recorded and, where appropriate, adequately disclosed in the financial statements:

- losses arising from sale & purchase commitments;
- agreements & options to buy back assets previously sold; and
- assets pledged as collateral.

Compensating arrangements

There are no formal or informal compensating balancing arrangements with any of our cash and investment accounts

Appendix 1 – Letter of representation

Contingent liabilities

There are no other contingent liabilities, other than those that have been properly recorded and disclosed in the financial statements. In particular:

- there is no significant pending or threatened litigation, other than those already disclosed in the financial statements;
- there are no material commitments or contractual issues, other than those already disclosed in the financial statements; and
- no financial guarantees have been given to third parties.

Related party transactions

I confirm the completeness of the information disclosed regarding the identification of related parties.

The identity of, and balances and transactions with, related parties have been properly recorded and where appropriate, adequately disclosed in the financial statements

Post balance sheet events

Since the date of approval of the financial statements by the Council, no additional significant post balance sheet events that have occurred which would require additional adjustment or disclosure in the financial statements.

The Council has no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.

Specific representations:

There are no other material amounts relating to unfunded liabilities, curtailments or settlements of past service costs relating to pension provision other than those which have been properly recorded and disclosed in the financial statements.

Signed on behalf of Southampton City Council

I confirm that this letter has been discussed and agreed by the Council on 25 September 2008.

Signed

Signed

Name: Carolyn Williamson

Name:

Position: Executive Director Resources

Position: Chair of Standards &
Governance Committee

Date: 25 September 2008.

Appendix 2 – Proposed auditor's report

Independent auditor's report to the Members of Southampton City Council

Opinion on the financial statements

I have audited the Authority's accounting statements and related notes of Southampton City Council for the year ended 31 March 2008 under the Audit Commission Act 1998. The Authority's accounting statements comprise the Authority's Income and Expenditure Account, the Authority's statement of the Movement on the General Fund Balance, the Authority's Balance Sheet, the Authority's Statement of Total Recognised Gains and Losses, the Authority's Cash Flow Statement, the Housing Revenue Account, the Collection Fund and the related notes. These accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to the members of Southampton City Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 36 of the Statement of Responsibilities of Auditors and of Audited Bodies prepared by the Audit Commission.

Respective responsibilities of the Executive Director of Resources and Chief Financial Officer and auditor

The Executive Director of Resources and Chief Financial Officer's responsibilities for preparing the financial statements in accordance with relevant legal and regulatory requirements and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2007 are set out in the Statement of Responsibilities for the Statement of Accounts.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the Authority's accounting statements present fairly, in accordance with relevant legal and regulatory requirements and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2007 the financial position of the Authority and its income and expenditure for the year.

I review whether the governance statement reflects compliance with 'Delivering Good Governance in Local Government: A Framework' published by CIPFA/SOLACE in June 2007. I report if it does not comply with proper practices specified by CIPFA/SOLACE or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered, whether the governance statement covers all risks and controls. Neither am I required to form an opinion on the effectiveness of the Authority's corporate governance procedures or its risk and control procedures.

Appendix 2 – Proposed auditor's report

I read other information published with the Authority's accounting statements, and consider whether it is consistent with the audited Authority's accounting statements. This other information comprises the Explanatory Foreword. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the Authority's accounting statements. My responsibilities do not extend to any other information.

Basis of audit opinion

I conducted my audit in accordance with the Audit Commission Act 1998, the Code of Audit Practice issued by the Audit Commission and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Authority's accounting statements and related notes. It also includes an assessment of the significant estimates and judgments made by the Authority in the preparation of the Authority accounting statements and related notes, and of whether the accounting policies are appropriate to the Authority's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the Authority's accounting statements and related notes are free from material misstatement, whether caused by fraud or other irregularity or error. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the Authority's accounting statements and related notes.

Opinion

In my opinion:

- The Authority's financial statements present fairly, in accordance with relevant legal and regulatory requirements and the Statement of Recommended Practice on Local Authority Accounting in the United Kingdom 2007, the financial position of the Authority as at 31 March 2008 and its income and expenditure for the year then ended.

Conclusion on arrangements for securing economy, efficiency and effectiveness in the use of resources

Authority's Responsibilities

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 regularly to review the adequacy and effectiveness of these arrangements.

Auditor's Responsibilities

I am required by the Audit Commission Act 1998 to be satisfied that proper arrangements have been made by the Authority for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires me to report to you my conclusion in relation to proper arrangements, having regard to relevant criteria specified by the Audit Commission for principal local authorities. I report if significant matters have come to my attention

which prevent me from concluding that the Authority has made such proper arrangements. I am not required to consider, nor have I considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Conclusion

I have undertaken my audit in accordance with the Code of Audit Practice and having regard to the criteria for principal local authorities specified by the Audit Commission and published in December 2006, I am satisfied that, in all significant respects, Southampton City Council made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2008.

Best Value Performance Plan

I have issued our statutory report on the audit of the Authority's best value performance plan for the financial year 2006/07 on 21 December 2007. I did not identify any matters to be reported to the Authority and did not make any recommendations on procedures in relation to the plan.

Certificate

The audit cannot be formally concluded and an audit certificate issued until I have completed my consideration of matters brought to my attention by local authority electors. This relates to heating charges in Council properties and is currently under review.

K.L.Handy

District Auditor, Audit Commission, Collins House, Bishopstoke Road, Eastleigh, Hampshire. SO50 6AD

September 2008.

Appendix 3 – Audit work to be completed

Job No. Area to test

Tangible fixed assets

- Capital accounting checklist
- Additions
- Physical verification
- Review of revenue expenditure
- Deeds/ownership papers
- Valuation report
- Constructed assets/enhancements
- Coding of assets and expenditure
- Council house sales

Debtors

- Agree to supporting information
- Adequacy of bad debts provision

Creditors

- Agree to supporting information

Deferred liabilities, credits and government grants

- New additions

Funds, balances and reserves

- Capital adjustment account

Capital Commitments

- Supporting documentation

Appendix 4 – Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
	Social care billing system					
8	R1 The Council should: <ul style="list-style-type: none"> continue to ensure that social care charges are correctly raised and accounted for during 2008/09; and prepare and implement the planned replacement social care charging policy during 2009/10. 	3				