

Annual governance report

Southampton City Council

Audit 2010/11



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Traffic light explanation

Red  Amber  Green 

Key messages

This report summarises the findings from the 2010/11 audit which is substantially complete. It includes the messages arising from my audit of your financial statements and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources.

	Our findings
Unqualified audit opinion	●
Proper arrangements to secure value for money	●

Audit opinion and financial statements

Subject to clearance of outstanding matters I plan to issue an unqualified audit opinion on your financial statements. Your accounts and supporting working papers were well prepared.

Value for money

I intend to issue an unqualified audit opinion on your arrangements to secure economy, efficiency and effectiveness in the use of resources.

As a Council, you:

- prepared your accounts on time and complied with the accounting code of practice for Local Government;
- delivered your 2010/11 budget;

- approved a balanced 2011/12 budget and responded promptly to the government's spending review;
- adopted an appropriate medium term financial plan identifying an initial funding shortfall of £49.5m and efficiencies and savings totalling £36.1m over the three years to 2013/14;
- are addressing the remaining shortfall, £13.2m phased £3m in 2012/13 rising to £13.2m cumulatively by 2013/14, through the budget setting process with a draft budget to be presented to Cabinet in October 2011;
- implemented your Highways Strategic Partnership and Street Lighting PFI and began to realise the planned benefits through these schemes; and
- delivered the first phase of your estates regeneration programme that has provided valuable experience and expertise that you can rely on when planning the initial stages of phase 2.

It is important that you now:

- complete the organisational restructure to improve how the Council works, including the planned reduction in management posts; and
- deliver the planned efficiencies and savings included in your financial plans.

Before I complete my audit

I confirm to you

My report includes only matters of governance interest that have come to my attention in performing my audit. My audit is not designed to identify all matters that might be relevant to you.

Independence

I have complied with the Auditing Practices Board's ethical standards for auditors, including ES 1 (revised) – Integrity, Objectivity and Independence. I have previously reported the steps that I have taken to ensure there are no threats to my independence, objectivity and integrity.

I have not undertaken, and neither has the audit practice undertaken, any non-audit work for the Council during 2010/11.

I ask you to confirm to me

I ask the Council to:

- Consider the matters presented in this report;
 - approve the letter of representation, provided alongside this report, for the Council before I issue my opinion and conclusion
-

Financial statements

Your financial statements and annual governance statement are important means by which you account for your stewardship of public funds. As Council members you have final responsibility for these statements. It is important that you consider my findings before you adopt the financial statements and the annual governance statement.

Opinion on the financial statements

Subject to satisfactory clearance of outstanding matters, I plan to issue an unqualified opinion on your financial statements. Appendix 1 contains a copy of my draft audit report.

The 2010/11 audit cannot be formally closed and an audit certificate issued until I have completed my consideration of matters that have been brought to my attention by local authority electors, about your 2009/10 financial statements. I am satisfied that these matters do not have a material effect on either the 2009/10 or 2010/11 financial statements.

Your financial statements

- 1** I am required to report to you those corrections made during my audit to your accounts that are, in my opinion, both important and relevant to your oversight of the financial reporting process.
- 2** There is only one error that I have identified that has not been corrected in your accounts. This is the Council's treatment of the 'equal pay provision' in the financial statements and in particular the Council's interpretation of Financial Reporting Standard 12 (FRS12). The Council has decided not to recognise its 'equal pay provision' in the financial statements because to do so would be prejudicial to its interest in ongoing litigation. I am satisfied that the provision is not material to my opinion audit, although it is above the threshold for trivial items (ie it amounts to more than £135k). I have asked officers to correct this misstatement, but they have declined to do so for the reasons set out above. Members should consider this issue before approving the 2010/11 financial statements and, if you agree with officers, include the reasons for not recognising the equal pay provision in the financial statements in the letter of management representations to me.

3 I have carefully considered each of the other adjustments made to your accounts, none affected the Council's general fund reserves or net asset position. Appendix 2 sets out details of the more significant corrections made that I judge are relevant to your responsibilities. Other than these, I identified five other non-material errors, none of which affected the Council's net assets or general fund balance. These errors included more minor omissions, misstatements or typographical errors in the notes to the core statements, and some inconsistencies between primary statements and supporting notes. Errors of this type are not unusual within the general accounts production process and in our view should not overly concern those charged with governance in approving the accounts. All the identified inconsistencies have now been amended. A few other minor presentational amendments to text and disclosures were made to ensure your statements fully comply with the accounting code of practice.

Specific risks identified by my planning

In planning my audit I identified specific risks and areas of judgement. I reported these to you in June and include below my final conclusions about each of them.

Key audit risk and our findings

Key audit risk	Finding
<p>1. Transition to International Financial Reporting Standards (IFRS)</p> <p>I planned to:</p> <ul style="list-style-type: none"> ■ review the restated accounts and comparatives for 2009/10 ahead of the year-end, and the revised accounting policies; and ■ pay particular attention to the higher risk areas of Property, Plant and Equipment (especially leases, contracts with embedded leases and component accounting), segmental reporting and accruals for employee benefits. 	<p>Your accounts comply with the IFRS</p>
<p>2. PFI schemes</p> <p>There are some areas where we have previously taken technical advice relating to the Schools PFI, the Waste Management contract, the Street Lighting PFI and BUPA care homes. The correct modelling of costs and recognition of assets remain relevant to the 2010/11 opinion audit</p>	<p>I have reviewed the treatment of PFI schemes and Non-PFI partnerships in your 2010/11 financial statements. There are no issues that I need to bring to your attention. There were two adjustments that were above my £135k triviality level that have been made. These were however immaterial and have not therefore been included in appendix 2.</p>
<p>3. Equal pay provision</p> <p>The Council will need to consider how to respond to the equal pay claims that it has received and decide whether to provide for these in 2010/11.</p>	<p>The Council has provided for its 'equal pay provision' in its financial ledger, but not recognised the provision in the 2010/11 financial statements. The financial statements therefore do not agree to the ledger for this one item.</p>

The Council has decided not to include this provision in its financial statements based on legal advice that to do so would prejudice its position in ongoing litigation. The Council believes Financial Reporting Standard 12 (FRS12) allows it not to include the provision in either the balance sheet or the notes.

I do not agree with the Council's interpretation of FRS12. I have sought technical advice which was that the provision should be included in the balance sheet but that FRS12 allows for the detail not be disclosed in the notes. Officers have declined to correct this misstatement for the reasons set out above.

You should consider this issue before approving the 2010/11 financial statements and, if you agree with officers, include the reasons for not recognising the equal pay provision in the financial statements in the letter of management representations to me.

4. Bank reconciliation

At the time of my pre statements audit the main bank account reconciliation included income which had not been accurately identified in both the IKON system (£3m) and the bank account (£2m). These balances were shown as reconciling items.

I have tested the bank reconciliation at the 31 March 2011 and confirmed there are no unidentified bankings/ credits in the reconciliation.

Significant weaknesses in internal control

I have not identified any significant weaknesses in internal control that I need to bring to your attention resulting from my 2010/11 audit.

I am still responding to matters brought to my attention by an elector about the heating charges that the Council has levied on tenants and leaseholders. These matters relate to the 2009/10 financial statements. Following my 2009/10 audit I made a few recommendations to improve the internal controls over heating charges. I have followed up the Council's progress in implementing those recommendations. My findings are set out in the table below.

Internal control issues and our findings

Description of weakness	Findings	Work still required
<p>1. Heating charges to tenants and leaseholders</p> <p>In 2009/10 I made four recommendations in respect of the tenant and leaseholder heating charges the Council raises and in particular the Council's meter record, which is used to calculate these charges.</p> <p>I have worked with your Internal Auditors to review the progress the Council has made in addressing each of my recommendations. Where errors have been identified, I have tested the financial corrections made to the heating charges account in 2010/11.</p>	<p>The Council has:</p> <ul style="list-style-type: none">■ implemented a new computer based meter record (System link) that is being evaluated through parallel running with the old meter record;■ confirmed the designation of electricity meters, with less than 10 outstanding. Established the extent of errors in the old meter record, calculated the financial impact of these errors and adjusted the heating charges account;■ begun to establish the refund of costs due from energy suppliers where charges were still being made for redundant meters,■ removed the cost of energy used in sheltered housing communal areas from the heating charges account; and■ confirmed that just over half of properties have been visited by the end of August 2011 and the gas meter read as part of the gas servicing cycle.	<p>Officers need to:</p> <ul style="list-style-type: none">■ evaluate the effectiveness of the new 'System link' meter record, through a post implementation review;■ confirm the designation of meters in the remaining 6 properties and reclaim the cost of overcharged energy costs from its energy suppliers; and■ complete the review gas meters through the annual gas servicing cycle.

These weaknesses are only those I identified during my audit that are relevant to preparing the financial statements. I am not expressing an opinion on the overall effectiveness of internal control.

Quality of your financial statements

I also consider the non-numeric content of your financial reporting. Your financial statements for 2010/11 had to comply with IFRS for the first time. This put extra pressure on your staff. Despite this extra work your financial statements and working papers produced in line with agreed timetables. Working papers were once again produced to a good standard to support the entries and disclosures in the accounts.

There are no other matters I need to bring to your attention.

Other matters

Finally, I reviewed your annual governance statement and confirmed that it complies with the code requirements and our knowledge and experience of the Council.

There are no other matters I wish to bring to your attention.

Letter of representation

Before I issue my opinion, auditing standards require me to ask you and management for written representations about your financial statements and governance arrangements. I have asked that you include your reasons for not recognising the 'equal pay provision' in your financial statements in your letter of representation.

Value for money

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 criteria specified by the Audit Commission and have reported the outcome as the value for money (VFM) conclusion.

I assess your arrangements to secure economy, efficiency and effectiveness in your use of resources against two criteria specified by the Audit Commission:

- the organisation has proper arrangements in place for securing financial resilience (Focus for 2010/11: The organisation has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future); and
- the organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness (Focus for 2010/11: The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity).

My value for money conclusion

My overall conclusion is the Council has proper arrangements to secure, economy, efficiency and effectiveness in its use of resources. The Council has made progress against each of the areas that I highlighted in my audit last year. A summary of my findings is set out in the table below.

Criterion	Findings
Financial resilience	The Council has a track record of strong financial management. It has implemented a robust response to manage the impact of the government's comprehensive spending review and it is closely monitoring the delivery of its identified efficiencies and savings plans. It is maintaining balances at a prudent level, ensuring there are funds to meet unexpected costs, deliver key priorities and provide scope for 'invest to save' schemes. The Council is restructuring into three core front line directorates, supported by a central core. This is designed to improve the efficient working of the Council and will lead to a reduction of senior management posts and the realisation of savings. Phase 1 of the restructure is

completed. A new 'Management Board of Directors' was set up in April 2011 and the number of directorates was reduced to 5, reducing the number of directors that are in post. The consultation process on phase 2 started at the end of July 2011 and will end in September 2011, before the new structure is implemented in November 2011.

The Council has implemented revised staff 'terms and conditions' (T&Cs) of employment for staff, although this was delayed until 11 July 2011, resulting in a £1.3m reduction in the originally planned savings in 2011/12. This shortfall is being made good from other one-off sources in 2011/12.

The Council's capital programme was underspent by £13.3m (9 per cent) in 2010/11, General Fund (GF) £11.4 m and Housing Revenue Account (HRA) £1.9m. The future capital programme that has been agreed over programmes GF resources by £9.2m and HRA by £3m. While this level of future over programming is in line with the Council's predetermined tolerances of 5 per cent (£15.5m) it will require close management to ensure the capital programme remains realistic and achievable.

Economy
efficiency and
effectiveness

The Council has taken action to prioritise resources and focus on its key corporate aims. Examples are as follows.

- Although almost all staff have accepted the revised Terms and Conditions that have been implemented as part of the planned savings programme, there has been industrial action that is still to be resolved which has been detrimental to front line services.
- The Council has implemented two major projects in 2010/11 the Highways Strategic Partnership (HSP) (£100m over 10 years) and the Street Lighting Partnership (£28.5m over 25 years). Realised benefits have been reported by these schemes in their first year. For example the HSP has achieved savings equivalent to £263k pa against the pre-HSP budgets in its first six-month period and financial cost savings of £211.8k against the four Highways Target Cost schemes. In its first year the Street Lighting PFI has delivered the replacement of 2,534 lighting units and has reduced energy consumption by 150,329 kWh. The Council is reviewing the governance and performance frameworks for these projects in 2011/12 and has responded positively to recommended improvements.
- The experience gained from the successful delivery of the phase 1 £16m Hinkler Parade estate regeneration scheme places the Council in a strong position when procuring and project managing the delivery of future estate regeneration schemes (phase 2 will be between £30m to £40m).
- Robust arrangements have been developed with the Southampton City Primary Care Trust for Adult Health and Social Care, combining annual budgets of £62.7m from the Council with £83m from Southampton City PCT. The application of these arrangements is being reviewed and tested by Internal Audit in 2011/12 to ensure that they are working effectively.
- External partners have been selected and contracts awarded for the management of the Council's sport and recreation facilities, these commenced in August and September 2010 respectively.

Appendix 1 - Draft Audit Report

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

Opinion on the Authority accounting statements

I have audited the accounting statements of Southampton City Council for the year ended 31 March 2011 under the Audit Commission Act 1998. The accounting statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement, the Housing Revenue Account, the Movement on the Housing Revenue Account Statement and 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 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010.

Respective responsibilities of the Chief Financial Officer and Auditor

As explained more fully in the Statement of the Head of Finance Responsibilities, the Head of Finance is responsible for the preparation of the Authority's Statement of Accounts in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom. My responsibility is to audit the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements sufficient to give reasonable assurance that the accounting statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Authority's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Authority; and the overall presentation of the accounting statements. I read all the information in the explanatory foreword to identify material inconsistencies with the audited accounting statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on accounting statements

In my opinion the accounting statements:

- give a true and fair view of the state of Southampton City Council's affairs as at 31 March 2011 and of its income and expenditure for the year then ended; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

Opinion on other matters

In my opinion, the information given in the explanatory foreword for the financial year for which the accounting statements are prepared is consistent with the accounting statements.

Matters on which I report by exception

I have nothing to report in respect of the governance statement on which I report to you if, in my opinion the governance statement does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007.

Conclusion on Authority's 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 to review regularly the adequacy and effectiveness of these arrangements.

Auditor's responsibilities

I am required under Section 5 of the Audit Commission Act 1998 to satisfy myself 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 Audit Commission requires me to report to you my conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

I report if significant matters have come to my attention which prevent me from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. 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.

Basis of conclusion

I have undertaken my audit in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the Audit Commission in October 2010, as to whether the Authority has proper arrangements for:

- securing financial resilience; and
- challenging how it secures economy, efficiency and effectiveness.

The Audit Commission has determined these two criteria as those necessary for me to consider under the Code of Audit Practice in satisfying myself whether the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2011. I planned my work in accordance with the Code of Audit Practice. Based on my risk assessment, I undertook such work as I considered necessary to form a view on whether, in all significant respects, the Authority had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Conclusion

On the basis of my work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2010, I am 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 ending 31 March 2011.

Delay in certificate of completion of the audit

The audit cannot be formally concluded and an audit certificate issued until I have completed my consideration of matters brought to my attention by a local authority elector in respect of the audit of the 2009/10 financial statements. I am satisfied that these matters do not have a material effect on the 2010/11 financial statements.

K. L. Handy
Officer of the Audit Commission
Collins House
Bishopstoke Road
Eastleigh
Hampshire
SO50 6AD

XX September 2011

Appendix 2 - Amendments made to your draft financial statements

I identified the following misstatements during my audit and management have adjusted the financial statements. I bring the them to your attention to aid you in fulfilling your governance responsibilities.

		comprehensive income and expenditure statement		Statement of financial position	
Adjusted misstatement	Nature of adjustment	Dr £'000s	Cr £'000s	Dr £'000s	Cr £'000s
<p>Financial foreword –Where the money came from</p> <p>The disclosed total amount of main sources of income for 2010/11 has been increased by £23.6m to £619.5m and 2009/10 by £50.7m to £594.6m.</p>	<p>The total amount of main sources of income had been misstated.</p>	N/A	N/A	N/A	N/A
<p>Equal pay provision</p> <p>Your original accounts included the 'equal pay provision' in the cash flow statement and supporting notes.</p>	<p>Following discussions, your officers removed this provision from the cash flow statement and supporting notes.</p>	N/A	N/A	N/A	N/A

<p>A transfer from 'provisions' to 'creditors' in respect of equal pay claims that had been determined in 2010/11 but not paid by 31 March 2011 has been reversed.</p>	<p>The original disclosure distorted the level of provisions made by the Council.</p>	<p>N/A</p>	<p>N/A</p>	<p>N/A</p>	<p>N/A</p>
<p>Events after the balance sheet date – note 8 The Council has disclosed an additional event after the balance sheet date in respect of the 'Integrated Commissioning of Learning Disabilities' agreement that it has entered with NHS Southampton City from the 1 April 2011.</p>	<p>This is a significant agreement that will involve the Council pooling £15.2 m per annum over the next 10 years.</p>	<p>N/A</p>	<p>N/A</p>	<p>N/A</p>	<p>N/A</p>
<p>Property, Plant and Equipment (capital commitments) – note 14 The Council's commitment in respect of the Lordshill Academy at 31 March 2011 has been added to note 14, totalling £13.96m.</p>	<p>This commitment had originally been omitted.</p>	<p>N/A</p>	<p>N/A</p>	<p>N/A</p>	<p>N/A</p>
<p>Capital grants and contributions receipts in advance – note 42 A detailed disclosure note has been added in respect of capital grants and contribution receipts in advance.</p>	<p>This disclosure is a requirement of the Code of Practice on local authority Accounting.</p>	<p>N/A</p>	<p>N/A</p>	<p>N/A</p>	<p>N/A</p>

Appendix 3 - Glossary

Annual governance statement

A statement of internal control prepared by an audited body and published with the financial statements.

Audit closure certificate

A certificate that I have completed the audit following statutory requirements. This marks the point when I have completed my responsibilities for the audit of the period covered by the financial statements.

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.

Materiality and significance

The Auditing Practices Board (APB) defines this concept as ‘an expression of the relative significance or importance of a particular matter for the financial statements as a whole. A matter is material if its omission would reasonably influence users of the financial statements, such as the addressees of the auditor’s report; also a misstatement is material if it would have a similar influence. Materiality may also be considered for any individual primary statement within the financial statements or of individual items included in them. We cannot define materiality mathematically, as it has both numerical and non-numerical aspects’.

The term ‘materiality’ applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

'Significance' applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit in relation to the financial statements. Significance has both qualitative and quantitative aspects.

Weaknesses in internal control

A weakness in internal control exists when:

- a control is designed, set up or used in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements quickly; or
- a control necessary to prevent, or detect and correct, misstatements in the financial statements quickly is missing.

An important weakness in internal control is a weakness, or a combination of weaknesses that, in my professional judgement, are important enough that I should report them to you.

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.

The Code of Audit Practice defines proper arrangements as corporate performance management and financial management arrangements that form a key part of the system of internal control. These comprise the arrangements for:

- planning finances effectively to deliver strategic priorities and secure sound financial health;
- having a sound understanding of costs and performance and achieving efficiencies in activities;
- reliable and timely financial reporting that meets the needs of internal users, stakeholders and local people;
- commissioning and buying quality services and supplies that are tailored to local needs and deliver sustainable outcomes and value for money;
- producing relevant and reliable data and information to support decision making and manage performance;
- promoting and displaying the principles and values of good governance;
- managing risks and maintaining a sound system of internal control;
- making effective use of natural resources;
- managing assets effectively to help deliver strategic priorities and service needs; and
- planning, organising and developing the workforce effectively to support the achievement of strategic priorities.

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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0844 798 7070

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

