



The Annual Audit Letter for Southwark Council

Year ended 31 March 2016

October 2016

Paul Dossett

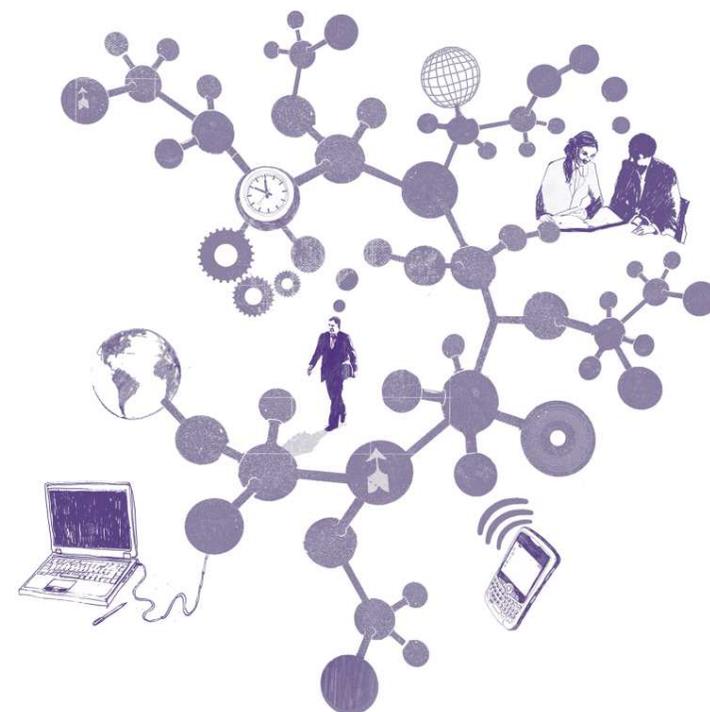
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Executive summary

Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Southwark Council (the Council) for the year ended 31 March 2016.

This Letter is intended to provide a commentary on the results of our work to the Council and its external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice (the Code) and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'.

We reported the detailed findings from our audit work to the Council's Audit, Governance and Standards Committee as those charged with governance in our Audit Findings Report on 14 September 2016.

Our responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council's financial statements (section two)
- assess the Council arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council financial statements, we comply with International Standards on Auditing (UK and Ireland) (ISAs) and other guidance issued by the NAO.

Our work

Financial statements opinion

We gave an unqualified opinion on the Council's financial statements on 26 September 2016.

Value for money conclusion

We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources during the year ended 31 March 2016. We reflected this in our audit opinion on 26 September 2016.

Whole of government accounts

The Council submitted its consolidation return for audit on 17 October 2016. This did not meet the deadline of 12 August for submission to HM Treasury. As a result of the late submission, we were unable to meet the deadline of 21 October for submission of the audited pack. At the time of writing, we are awaiting responses to audit queries that will enable us to complete our audit work and submit the final pack.

Certificate

We are currently unable to certify that we have completed the audit of the accounts of Southwark Council as we have not yet completed the work required under the Code on the Council's Whole of Government Accounts.

Certification of grants

We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. Our work on this claim is not yet complete and will be finalised by 30 November 2016. We will report the results of this work to the Audit, Governance and Standards Committee in our Annual Certification Letter.

Other work completed

We are in the process of performing independent assurance audit work on the Teachers' Pension return and the Pooling of Housing Capital Receipts. Our work on both returns are not yet complete and will be finalised by 30 November 2016 in line with national deadlines.

Working with the Council

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's staff.

Grant Thornton UK LLP
October 2016

Audit of the accounts – Southwark Council and Pension Fund

Our audit approach

Materiality

In our audit of the Council's accounts, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for our audit of the Council's accounts to be £18,056,000, which is 2% of the Council's gross revenue expenditure. We used this benchmark as, in our view, users of the Council's accounts are most interested in how it has spent the income it has raised from taxation and grants during the year.

We also set a lower level of specific materiality for certain areas such as cash . We set a lower threshold of £500,000, above which we reported errors to the Audit, Governance and Standards Committee in our Audit Findings Report.

Pension Fund

For the audit of the Southwark Pension Fund accounts, we determined materiality to be £8,734,000, which is 1% of the Fund's net assets. We used this benchmark as, in our view, users of the Pension Fund accounts are most interested in the value of assets available to fund pension benefits.

The scope of our audit

Our audit involves obtaining enough evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error.

This includes assessing whether:

- the Council's accounting policies are appropriate, have been consistently applied and adequately disclosed;
- significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the narrative report and annual governance statement to check they are consistent with our understanding of the Council and with the accounts on which we give our opinion.

We carry out our audit in line with ISAs (UK and Ireland) and the NAO Code of Audit Practice. We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Council's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the accounts – Southwark Council and Pension Fund (continued)

These are the risks which had the greatest impact on our overall strategy for both the Council and the Pension Fund and are where we focused our work.

Risks identified in our audit plan	How we responded to the risk
<p>The revenue cycle includes fraudulent transactions</p> <p>Under ISA 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.</p> <p>This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.</p>	<p>Having considered the risk factors set out in ISA 240 and the nature of the revenue streams at Southwark Council, we determined that the risk of fraud arising from revenue recognition can be rebutted, because:</p> <ul style="list-style-type: none"> • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited; and • the culture and ethical frameworks of local authorities, including Southwark Council, mean that all forms of fraud are seen as unacceptable. <p>Our audit work did not highlight any issues in respect of revenue recognition.</p>
<p>Management over-ride of controls</p> <p>Under ISA 240 it is presumed that the risk of management over-ride of controls is present in all entities.</p>	<p>Work completed to address this risk included:</p> <ul style="list-style-type: none"> • Review of entity level controls • Review of accounting estimates, judgements and decisions made by management • Testing of journal entries • Review of unusual significant transactions <p>Our audit work did not identify any evidence of management over-ride of controls. In particular, the findings of the review of journal controls and testing of journal entries did not identify any significant issues.</p>

Audit of the accounts – Southwark Council and Pension Fund (continued)

Audit opinion

We gave an unqualified opinion on the Council's accounts on 26 September 2016, in advance of the 30 September 2016 national deadline.

The key messages arising from our audit of the Council and Pension Fund financial statements were:

- The valuation of Council dwellings at 31 March 2016 did not fully reflect the uplift in values during the period. This was as a result of a number of properties not having the uplift applied. The revaluation has been reviewed in full to ensure that all dwellings are included and this has resulted in an increase in valuation of £45,429k. The adjustment will have no impact on general fund balances, but the exact changes required are still being finalised by the Council. The Audit, Governance & Standards Committee will be updated at the meeting on 14 September.
- The Council made the accounts available for audit in line with the agreed timetable, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit. The draft financial statements were of a high quality and the only adjustments required were minor misclassification and disclosure amendments. We also recommended some enhancement to the narrative in the notes to improve the presentation of the financial statements. All amendments have been processed by management.

We reported the key issues from our audit of the accounts of the Council and the Pension Fund to the Council's Audit, Governance and Standards Committee on 14 September 2016.

Annual Governance Statement and Narrative Report

We are also required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website with the draft accounts in line with the national deadlines.

Both documents were prepared in line with the relevant guidance and were consistent with the supporting evidence provided by the Council/Authority and with our knowledge of the Council/Authority.

Whole of government accounts

The Council submitted its consolidation return for audit on 17 October 2016. This did not meet the deadline of 12 August for submission to HM Treasury. As a result of the late submission, we were unable to meet the deadline of 21 October for submission of the audited pack. At the time of writing, we are awaiting responses to audit queries that will enable us to complete our audit work and submit the final pack.

Other statutory duties

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice (the Code), following the guidance issued by the NAO in November 2015 which specified the criterion for auditors to evaluate:

In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work.

The key risks we identified and the work we performed are set out overleaf.

Overall VfM conclusion

We are satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2016.

Value for Money conclusion (continued)

Risk identified	Work carried out	Findings and conclusions
<p>The Council has a significant regeneration programme underway designed to reshape the Borough and improve community outcomes. We considered the Council's arrangements in place to monitor and report the outcomes resulting from these regeneration programmes</p>	<p>In order to understand the processes in place at the Council, we completed a high level review of two major projects:</p> <ul style="list-style-type: none"> • Canada Water (£4bn project) • Elephant & Castle (£3bn project) <p>As part of this process we attempted to understand the following:</p> <ul style="list-style-type: none"> • the background to the project • how progress is monitored • who is responsible for the monitoring • the risk management of the project 	<p>No significant issues were noted from the review of governance in place around the sampled regeneration projects.</p> <p>The Elephant & Castle project has a clearly structured monitoring process in place, primarily through the monthly operational meetings and the quarterly strategic board. Both of these are attended by senior Council officers. No issues have been noted from a high level review of the items discussed at these meetings.</p> <p>The Canada Water project is at a much earlier stage, but the plans in place clearly set out what the Council is trying to achieve with the project, alongside how this will be monitored. There is a clear identification of the importance of following the progress of the plan in order to ensure that the set objectives are being met and a monitoring framework has been established</p>
<p>As a result of the significant financial pressures facing local government, the Council has undertaken large scale restructuring and reduction of its workforce to meet these challenges to 2020 and beyond. We considered the Council's arrangements for reshaping its workforce to meet the financial, demographic, digital and cultural changes of enabling and providing public services to its diverse and ever changing communities</p>	<p>Through discussions with senior officers, we completed a review of the processes in place at the Council in order to understand the arrangements in place for reshaping the Council's workforce and arrangements that are in place to support and monitor this.</p>	<p>No significant issues have been identified from consideration of the restructuring process in place at the Council.</p> <p>The current process in place appear to be fundamentally sound, with strong HR processes in place around recruitment and retention.</p> <p>Going forward, the Council is looking to take a more strategic focus over how it restructures in order to ensure that it is going to be fit for the 21st century.</p>
<p>The Council has significant contracts in place with private sector providers to deliver a range of services taking up a growing proportion of the revenue budget. We reviewed the arrangements for monitoring these contracts and ensuring they continue to provide value for money in the context of the funding challenges facing local government.</p>	<p>In order to understand the processes in place at the Council, we completed a high level review of two major contracts:</p> <ul style="list-style-type: none"> • Capita IT contract • Keepmoat Homes contract 	<p>Based on our high-level review of the Capita contract management arrangements, overall we have found the Council has effective arrangements in place to manage the contract and monitor performance of the provider. The Council has been disappointed with the performance of Capita and is preparing to go out to market to procure a new provider.</p> <p>Based on our high level review of the Keepmoat contract management arrangements, overall we have found the Council has effective arrangements in place to manage the contract and monitor performance of the provider. The Council has been pleased with the performance of Keepmoat and their flexibility in terms of their service and response to major works being completed within cost and to the required quality standards.</p>

Working with the Council

Our work with you in 2015/16

We are really pleased to have worked with you over the past year. We have established a positive and constructive relationship. Together we have delivered some great outcomes.

An efficient audit – we delivered the accounts audit ahead of the national deadline and in line with the timescale we agreed with you. Our audit team are knowledgeable and experienced in your financial accounts and systems. Our relationship with your team provides you with a financial statements audit that continues to finish ahead of schedule releasing your finance team for other important work.

Improved financial processes – during the year we reviewed your financial systems and processes including employee remuneration, non- pay expenditure, property plant and equipment, housing revenue account and welfare expenditure. We worked with you to streamline your processes including journals, fixed assets and made comments to improve controls over the access to scanned contracts of employment.

Understanding your operational health – through the value for money conclusion we provided you with assurance on your operational effectiveness.

Sharing our insight – we provided regular Audit, Governance and Standards Committee updates covering best practice. Areas we covered included 'Innovation in public financial management', 'Knowing the Ropes – Audit Committee; Effectiveness Review', 'Making Devolution Work', and 'Re-forging Local Government. We have also shared with you our insights on advanced closure of local authority accounts, in our publication 'Transforming the Financial Reporting of Local Authority Accounts' and will continue to provide you with our insights as you bring forward your production of your year-end accounts.

Working with the Council (continued)

Working with you in 2016/17 - Highways Network Asset

The Code of Practice on Local Authority Accounting (the Code) requires authorities to account for Highways Network Asset (HNA) at depreciated replacement cost (DRC) from 1 April 2016. The Code sets out the key principles but also requires compliance with the requirements of the recently published Code of Practice on the Highways Network Asset (the HNA Code), which defines the assets or components that will comprise the HNA. This includes roads, footways, structures such as bridges, street lighting, street furniture and associated land. These assets should always have been recognised within Infrastructure Assets.

The Code includes transitional arrangements for the change in asset classification and the basis of measurement from depreciated historic cost (DHC) to DRC under which these assets will be separated from other infrastructure assets, which will continue to be measured at DHC.

This is expected to have a significant impact on the Council's 2016/17 accounts, both in values and levels of disclosure, and may require considerable work to establish the opening inventory and condition of the HNA as at 1 April 2016.

Under the current basis of accounting values will only have been recorded against individual assets or components acquired after the inception of capital accounting for infrastructure assets by local authorities. Authorities may therefore have to develop new accounting records to support the change in classification and valuation of the HNA.

The nature of these changes means that Finance officers will need to work closely with colleagues in the highways department and potentially also to engage other specialists to support this work.

Some of the calculations are likely to be complex and will involve the use of external models, a combination of national and locally generated rates and a number of significant estimates and assumptions.

We have been working with the Council on the accounting, financial reporting and audit assurance implications arising from these changes. We have issued two Client Briefings which we have shared with the finance team. We will issue further briefings during the coming year to update the Council on key developments and emerging issues.

This significant accounting development is likely to be a significant risk for our 2016/17 audit, so we have already had some preliminary discussions with the Council to assess the progress it is making in this respect.

We will continue to liaise closely with the senior finance team during 2016/17 on this important accounting development, with timely feedback on any emerging issues.

The audit risks associated with this new development and the work we plan to carry out to address them will be reflected in our 2016/17 audit plan.

Appendix A: Reports issued and fees

We confirm below our final fees charged for the audit.

Fees

	Planned £	Actual fees £	2014/15 fees £
Statutory audit of the Council	237,296	237,296	316,394
Statutory audit of the Pension Fund	21,000	21,000	21,000
Housing Benefit Grant Certification (i)	17,717	TBC	24,047
Total fees (excluding VAT)	276,013	TBC	361,441

(i) Certification of grant claims and returns is on-going, so this remains a work in progress at the date of this letter. Based on the work completed to date, we expect our fees to be in line with the scale fee above. Confirmation of the final fee will be included within the separate Certification Report later in the year

Fees for other services

Service	Fees £
Audit related services:	
• Teachers Pensions Return (15/16 claim)	TBC
• Pooling of Housing Capital Receipts (1516 claim)	TBC
Non-audit services	
• Investors in People accreditation	28,660
• Analysis of accounts of comparable authorities to provide benchmark data	10,000
• CFO Insights	10,000
• Financial Resilience – Capacity Building Programme	8,750

Reports issued

Report	Date issued
Audit Plan	February 2016
Audit Findings Report	September 2016
Annual Audit Letter	October 2016
Certification Report	Will be issued in December 2016



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