



# Informing the audit risk assessment for Southwark Council and Southwark Pension Fund

**Year ended 31 March 2017**

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**Paul Dossett**

Engagement Lead

T +44 (0)20 7728 3180

E Paul.Dossett@uk.gt.com

**Nick Taylor**

Senior Audit Manager – Council audit

T +44 (0)1223 225 514

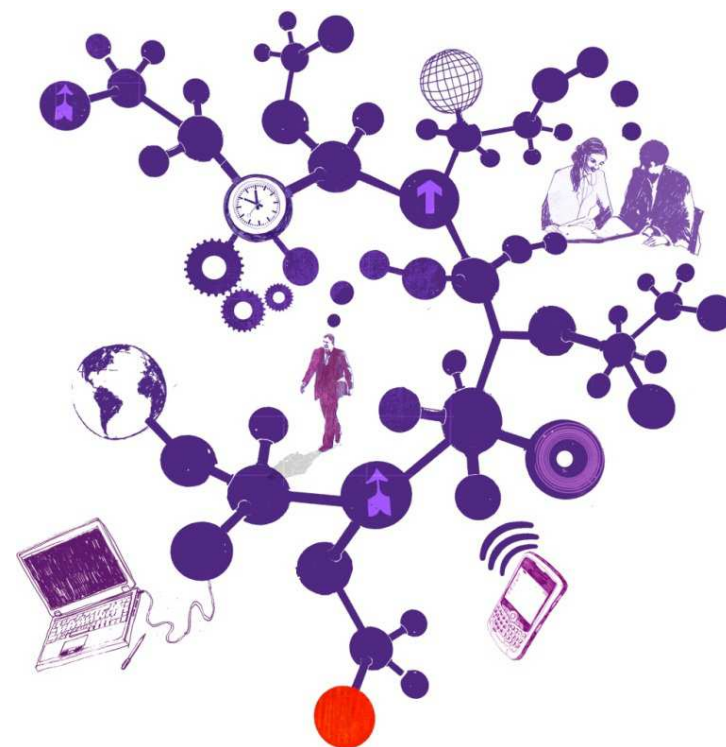
E nick.taylor@uk.gt.com

**Richard Lawson**

Audit Manager – Pension Fund audit

T +44 (0)7766 442 038

E richard.lawson@uk.gt.com



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# Purpose

The purpose of this report is to contribute towards the effective two-way communication between auditors and the Council's Audit, Governance and Standards Committee, as 'those charged with governance'. The report covers some important areas of the auditor risk assessment where we are required to make inquiries of the Audit, Governance and Standards Committee under auditing standards.

## Background

Under International Standards on Auditing (UK and Ireland) (ISA(UK&I)) auditors have specific responsibilities to communicate with the Audit, Governance and Standards Committee. ISA(UK&I) emphasise the importance of two-way communication between the auditor and the Audit, Governance and Standards Committee and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Audit, Governance and Standards Committee in understanding matters relating to the audit and developing a constructive working relationship. It also enables the auditor to obtain information relevant to the audit from the Audit, Governance and Standards Committee and supports the Audit, Governance and Standards Committee in fulfilling its responsibilities in relation to the financial reporting process.

## Communication

As part of our risk assessment procedures we are required to obtain an understanding of management processes and the Audit, Governance and Standards Committee's oversight of the following areas:

- fraud;
- laws and regulations; and
- going concern.

This report includes a series of questions on each of these areas and the response we have received from the Council's management. The Audit, Governance and Standards Committee should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.

# Fraud

## Issue

### Matters in relation to fraud

ISA(UK&I)240 covers auditors responsibilities relating to fraud in an audit of financial statements.

The primary responsibility to prevent and detect fraud rests with both the Audit, Governance and Standards Committee and management. Management, with the oversight of the Audit, Governance and Standards Committee, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of its oversight, the Audit, Governance and Standards Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error. We are required to maintain professional scepticism throughout the audit, considering the potential for management override of controls.

As part of our audit risk assessment procedures we are required to consider risks of fraud. This includes considering the arrangements management has put in place with regard to fraud risks including:

- assessment that the financial statements could be materially misstated due to fraud;
- process for identifying and responding to risks of fraud, including any identified specific risks;
- communication with the Audit, Governance and Standards Committee regarding its processes for identifying and responding to risks of fraud; and
- communication to employees regarding business practices and ethical behaviour.

We need to understand how the Audit, Governance and Standards Committee oversees the above processes. We are also required to make inquiries of both management and the Audit, Governance and Standards Committee as to their knowledge of any actual, suspected or alleged fraud. These areas have been set out in the fraud risk assessment questions below together with responses from the Council's management.

# Fraud risk assessment

Question	Management response
<p>Has the Council assessed the risk of material misstatement in the financial statements due to fraud? What are the results of this process?</p>	<p>The council is required to manage its affairs to secure the economic, efficient and effective use of resources and to safeguard its assets. It has appointed the strategic director of finance and governance as the officer responsible for proper administration of its financial affairs (the S.151 officer). As part of his responsibilities, he is required to prepare the statement of accounts and in order to do this, he has taken reasonable steps to prevent and detect fraud. This risk is therefore considered as part of the overall internal audit and anti-fraud proactive planning processes (see below).</p>
<p>What processes does the Council have in place to identify and respond to risks of fraud?</p>	<p>Fraud risk assessments are undertaken by the anti-fraud service. These risks are considered as part of the internal audit and anti-fraud proactive planning processes and discussed with management.</p> <p>Management are ultimately responsible for managing the risks, but internal audit consider the control environment and provide challenge where appropriate. Significant control weaknesses, or those which remain unaddressed would be reported to the Audit, Governance and Standards (AGS) committee via the Internal Audit and Anti fraud progress reports.</p>
<p>Have any specific fraud risks, or areas with a high risk of fraud, been identified and what has been done to mitigate these risks?</p>	<p>As above, fraud risks are considered as part of annual internal audit and anti-fraud proactive planning . Proactive activities in both plans look at detection and prevention measures and make recommendations on controls. The plans and reports on proactive activities, and internal audit coverage, are all reported to the AGS committee. Any specific issues are also reported as part of the progress report.</p> <p>Ongoing issues include various forms of tenancy related fraud, and information gained through the national fraud initiative. The council also monitors sector reports for emerging issues, to incorporate into the proactive fraud plan and is part of the London Counter Fraud Hub pilot project to help with fraud prevention and detection.</p>

## Fraud risk assessment (continued)

Question	Management response
<p>Are internal controls, including segregation of duties, in place and operating effectively?</p> <p>If not, where are the risk areas and what mitigating actions have been taken?</p>	<p>Internal controls are operated and updated by management and reviewed by internal audit. Any concerns or breaches would be advised to management and the AGS committee through the internal audit and anti-fraud progress reports.</p> <p>These areas are considered through the key financial audits and health checks with actions being agreed to address any issues arising. In addition, these are confirmed through follow up work.</p>
<p>Are there any areas where there is a potential for override of controls or inappropriate influence over the financial reporting process (for example because of undue pressure to achieve financial targets)?</p>	<p>The key financial systems are subject to either a full audit or health check annually and no significant issues have been identified from this process.</p> <p>The findings of these reviews are reported to the AGS committee via the internal audit progress reports. Regular council-wide revenue and capital monitoring reports to cabinet give visibility to the in-year position and forecasts and enable issues and concerns to be raised promptly and publically.</p>
<p>Are there any areas where there is a potential for misreporting override of controls or inappropriate influence over the financial reporting process?</p>	<p>The key financial systems are subject to either a full audit or health check annually and no significant issues have been identified from this process. The findings of these reviews are reported to the AGS committee via the internal audit progress reports.</p>
<p>How does the Audit, Governance and Standards Committee exercise oversight over management's processes for identifying and responding to risks of fraud?</p> <p>What arrangements are in place to report fraud issues and risks to the Audit, Governance and Standards Committee?</p> <p>How has the Council ensured that the Audit, Governance and Standards Committee are made aware of whistleblower tips or complaints?</p>	<p>The annual internal audit plan and anti-fraud proactive plan are reported to the AGS committee, highlighting potential areas of risk. The internal audit progress reports also identify any control weaknesses. The progress report also includes outcomes from fraud investigations</p> <p>The AGS committee also receive an annual report on whistle blowing outcomes, and the format of these reports has been reviewed recently to provide more information to the committee.</p>

## Fraud risk assessment (continued)

Question	Management response
How does the Council communicate and encourage ethical behaviour of its staff and contractors?	<p>The council has an induction programme for new recruits, and a fraud and bribery response plan. Information and relevant documents are communicated via the intranet site and the council also offers training and awareness on anti-fraud which includes ethical behaviour. The staff code of conduct requires reporting of gifts and hospitality. Staff and any external advisors involved in procurements are also required to complete declarations of interest.</p> <p>The council's rules on gifts and hospitality are set out in the code of conduct, and relevant staff (including those involved in contracting) complete a declaration of interests.</p> <p>The Fairer Future Procurement Strategy and other council policies have encouraged ethical behaviour by contractors in areas such as the London Living Wage, anti-blacklisting and tax compliance.</p>
How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?	<p>A fraud and bribery response plan is in place, along with whistle blowing procedures. There is also an anonymous fraud hotline and email. No significant issues have been reported. Any significant cases would be reported to the AGS committee as and when appropriate.</p>
Are you aware of any related party relationships or transactions that could give rise to risks of fraud?	<p>No. Related party transactions are reviewed as part of the statement of accounts and no matters of concern have been raised.</p> <p>If required, the financial statements would include necessary disclosures.</p> <p>Should this give rise to concerns the fraud and bribery response plan would be invoked.</p>

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## Fraud risk assessment (continued)

Question	Management response
Are you aware of any instances of actual, suspected or alleged, fraud, either within the Council as a whole or within specific departments since 1 April 2016?	<p>Yes. The council continues to maintain a high profile anti-fraud stance and to vigorously pursue those who attempt to defraud the council of the public funds which it administers. Once investigations have been completed, they are reported to the AGS committee. Any significant issues will also be subject to an internal audit and the findings reported to the AGS committee.</p> <p>Where appropriate the council will publicise anti-fraud prosecutions.</p>

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# Laws and regulations

## Issue

### Matters in relation to laws and regulations

ISA(UK&I)250 requires us to consider the impact of laws and regulations in an audit of the financial statements.

Management, with the oversight of the Audit, Governance and Standards Committee, is responsible for ensuring that the Council's operations are conducted in accordance with laws and regulations including those that determine amounts in the financial statements.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error, taking into account the appropriate legal and regulatory framework. As part of our risk assessment procedures we are required to make inquiries of management and the Audit, Governance and Standards Committee as to whether the entity is in compliance with laws and regulations. Where we become aware of information of non-compliance or suspected non-compliance we need to gain an understanding of the non-compliance and the possible effect on the financial statements.

Risk assessment questions have been set out below together with responses from management.

# Impact of laws and regulations

Question	Management response
<p>What arrangements does the Council have in place to prevent and detect non-compliance with laws and regulations?</p>	<p>The council's governance framework, including the constitution, member and employee codes of conduct and scheme of management, aims to minimise the risk of non-compliance with laws and regulations. The programme of internal and external audit reviews identifies control weaknesses and action plans are agreed to deal with issues raised. Advice on laws and regulations is provided by the Law and Democracy division, with specialist external legal advice sought as required.</p> <p>The monitoring officer has regular meetings with all strategic directors to identify areas of risk. The council's whistle blowing policy enables staff to report suspected unlawful conduct. Cabinet reports and other reports to decision making meetings include a concurrent statement from the director of law and democracy.</p>
<p>How does management gain assurance that all relevant laws and regulations have been complied with?</p>	<p>Management gains assurance through reports from internal and external audit and also relevant inspection agencies. Departmental performance monitoring and reporting also provides assurance.</p> <p>Significant reports to cabinet and, in respect of procurement-related decisions, to other decision takers, include a concurrent from the director of law and democracy.</p>
<p>How is the Audit, Governance and Standards Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>As noted above, discussions have been held with strategic directors on their service provision.</p> <p>The AGS committee receives internal and external audit progress reports throughout the year. The AGS committee also receives and approves the annual governance statement, which identifies any significant governance exceptions.</p>

# Impact of laws and regulations

Question	Management response
Have there been any instances of non-compliance or suspected non-compliance with law and regulation since 1 April 2016, or earlier with an on-going impact on the 2016/17 financial statements?	<p>There are instances of successful legal action against the council. The most significant of these has been the Thames Water reselling case.</p> <p>Where required, appropriate management action is taken and processes improved based on lessons learned.</p>
What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?	<p>The council maintains a legal services exceptional risk register in accordance with Law Society Practice Management Standards and in line with Lexcel Accreditation requirements. All legal cases are reviewed every 6 weeks and, if one of more of the following applies, will be considered to be exceptional risk.</p> <ul style="list-style-type: none"><li>• A significant risk of substantial financial loss to the council</li><li>• Substantially novel or uncertain area of law</li><li>• Significant resource or skills issue for Legal Services</li><li>• The case is likely to attract significant judicial criticism</li><li>• The case is in the Court of Appeal</li><li>• Damage to the council's reputation.</li></ul>
Is there any actual or potential litigation or claims that would affect the financial statements?	<p>The council is involved in a number of legal cases, either as a defendant to actions brought against the council or as a claimant when proceedings are issued to protect the council's legal interest or to recover money owing to the council. We would describe these activities as routine legal work, which in our opinion do not expose the council to any significant legal or material financial risk.</p>
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	<p>There have been no reports from other regulatory bodies which indicate non-compliance.</p>

# Going concern

## Issue

### Matters in relation to going concern

ISA(UK&I)570 covers auditor responsibilities in the audit of financial statements relating to management's use of the going concern assumption in the financial statements.

The going concern assumption is a fundamental principle in the preparation of financial statements. Under this assumption entities are viewed as continuing in business for the foreseeable future. Assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

The code of practice on local authority accounting requires an authority's financial statements to be prepared on a going concern basis. Although the Council is not subject to the same future trading uncertainties as private sector entities, consideration of the key features of the going concern provides an indication of the Council's financial resilience.

As auditor, we are responsible for considering the appropriateness of use of the going concern assumption in preparing the financial statements and to consider whether there are material uncertainties about the Council's ability to continue as a going concern that need to be disclosed in the financial statements. We discuss the going concern assumption with management and review the Council's financial and operating performance.

Going concern considerations have been set out below and management has provided its response.

# Going concern considerations

Question	Management response
Does the Council have procedures in place to assess the Council's ability to continue as a going concern?	Yes – the council is required to set a balanced general fund and housing revenue account budget and to approve a treasury management strategy each year. Revenue and capital monitoring reports are taken to cabinet throughout the year and regular reports on treasury management are also taken to cabinet and council assembly. Overview and scrutiny committee is able to call in decisions of cabinet and the AGS committee considers treasury management during the year. Robust risk management processes include the maintenance of a corporate risk register and responsibility for risk management at cabinet member level. Reports on risk management are taken to the AGS committee.
Is management aware of the existence of other events or conditions that may cast doubt on the Council's ability to continue as a going concern?	<p>No – management do not believe that there is doubt over the council's ability to continue to exist as a going concern. The council submitted an Efficiency Statement to government in October 2016 covering the four year settlement term to 2019-20.</p> <p>However, government funding reductions continue to put significant strain on the council's own resources and, in particular, the maintenance of reserves and balances at current levels, to reflect known commitments and financial risks.</p> <p>For the pension fund, the triennial review will require the council to revisit existing investment strategies, which must now be placed in the context of the government's move towards the pooling of funds.</p>
Has management reported on going concern to the Audit, Governance and Standards Committee? (if not, what arrangements are in place to report the going concern assessment to the Audit, Governance and Standards Committee?)	No, not specifically, but the AGS committee considers the treasury management strategy each year and receives a report on top risks each year. The AGS committee also receives and approves the statement of accounts and annual governance statement each year. The committee is able to request additions to its work programme at any time to reflect matters arising during the course of a year.

## Going concern considerations (continued)

Question	Management response
Are the financial assumptions (e.g. future levels of income and expenditure) used in reporting going concern to the Audit, Governance and Standards Committee consistent with the Council's Business Plan and the financial information provided to the Council throughout the year?	Yes – as noted above, the council is required to set a balanced budget and this will have taken into account relevant financial assumptions and financial information provided throughout the year. This is also reflected in the council's Efficiency Statement
Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	Yes – reports to cabinet throughout the year set out implications of statutory or policy changes and these are also addressed in reports to cabinet on the policy and resources strategy for future years. Where necessary, reports to cabinet contain a section on resource implications and a concurrent from the strategic director of finance and governance.
Have there been any significant issues raised with the Audit, Governance and Standards Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).	There have been three internal audit reviews (out of 47) in the period 1 February 2016 to 17 January 2017 which concluded that the council could not take assurance as to the controls in place. Management has agreed action plans to address issues raised and follow up work carried out by internal audit has provided assurance that there are no ongoing issues which could cast doubts on the assumptions made.
Does a review of available financial information identify any adverse financial indicators including negative cash flow?  If so, what action is being taken to improve financial performance?	No, not in relation to the council's accounts.  In relation to the pension fund, the cash position is kept under review, with funds being replenished as required from fund managers.

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## Going concern considerations (continued)

Question	Management response
<p>Does the Council have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Council's objectives?</p> <p>If not, what action is being taken to obtain those skills?</p>	<p>Yes – and further restructuring continues to be undertaken within departments to ensure that the council remains able to deliver the council's objectives effectively and deal with new challenges.</p> <p>All staff have a work programme which sets objectives and targets, in line with the council's council plan, and as part of this, learning and development needs are identified to ensure that staff remain appropriately trained.</p>



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