



The Annual Audit Letter for Southwark Council

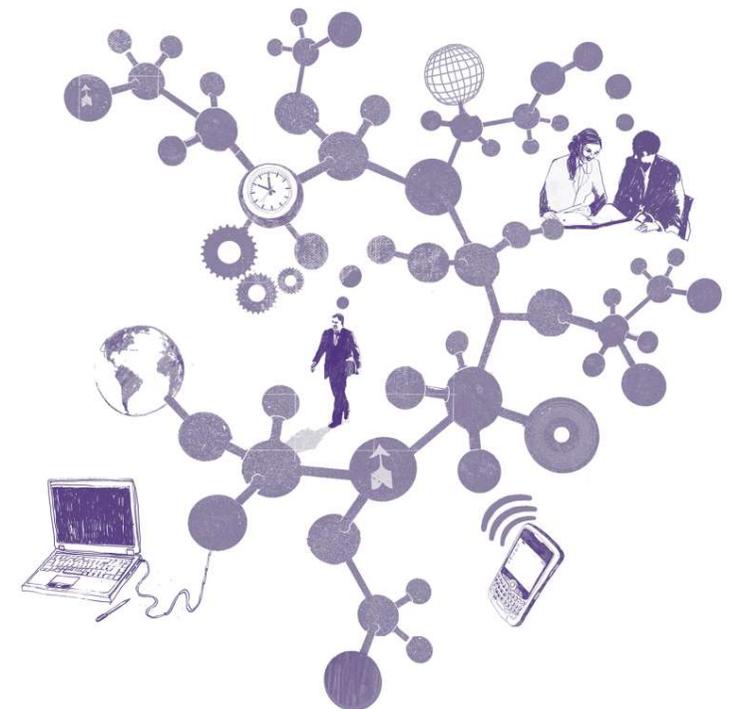
Year ended 31 March 2017

18 October 2017

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Executive summary

Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work we have carried out at Southwark Council (the Council) for the year ended 31 March 2017.

This Letter provides a commentary on the results of our work to the Council and its external stakeholders, and highlights issues 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 13 September 2017.

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's 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's 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 28 September 2017.

Value for Money (VfM) 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 2017. We reflected this in our VfM Conclusion on 28 September 2017.

Use of additional powers and duties

We are required under the Act to give electors the opportunity to raise questions about the Council's accounts and we consider and decide upon objections received in relation to the accounts.

We received an objection from a local elector relating to some of the Investments held by the Pension Fund. At the date of issuing this Letter we are still considering this objection, and will update the Council once we are in a position to conclude our work in this area.

As a result we are unable to certify the completion of the audit until we have finished our consideration of this objection.

Whole of Government Accounts (WGA)

We completed our work on the Council's consolidation return following guidance issued by the NAO and issued an unqualified report on 29 September 2017.

Certificate

As mentioned on the previous page, we are unable to issue our certificate confirming the completion of the audit until we have completed our consideration of the Objection received in respect of the Council's Accounts. Once we have completed our consideration then we will issue our certification in a timely manner.

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 2017. We will report the results of this work to the Audit, Governance and Standards Committee in our Annual Certification Letter.

Working with the Council

From 2017/18, the statutory deadlines for preparation and audit of the financial statements will be brought forward and the Council will be required to produce draft statements by 31 May, and secure an audit opinion by 31 July 2018.

We will work in partnership with the Council to complete a substantial amount of early audit testing prior to March 2018 which will help to drive efficiencies within the year end audit process.

Moving towards an earlier deadline, particularly within the more complex environment within which you now operate, will require an element of redesign of some of the closedown processes, arrangements and internal business processes.

We know the Council is continuing to review and develop its processes in advance of next year, and we will make sure that we help the Council with these developments where possible. We have worked with many large clients to successfully implement faster close and will continue to work with the Council during the coming year to support the Council in achieving the earlier deadlines.

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 2017

Audit of the accounts

Our audit approach

Materiality

In our audit of the Council's accounts, we applied the concept of materiality to determine the nature, timing and extent of our work, and to evaluate 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 £25.0 million, 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 Cash (£500k), disclosures of Officers Remuneration, Salary Bandings and Exit Packages, along with the disclosure of Auditor's Remuneration (£1k for all of the remaining items).

We set a lower threshold of £1,260,000, 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 £12.6 million, 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.

We set a lower level of specific materiality for Management Expenses, which was set at £747k. We set a threshold of £747,000 above which we reported errors to the Audit, Governance and Standards Committee.

The scope of our audit

Our audit involves obtaining enough evidence about the amounts and disclosures in the financial statements to give reasonable assurance 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 the Chief Financial Officer 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 included in the Statement of Accounts on which we gave 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 - Council

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>The revenue cycle includes fraudulent transactions</p> <p>Under ISA (UK&I) 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 ISA240 and the nature of the revenue streams at Southwark Council, we have 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 the London Borough of Southwark, mean that all forms of fraud are seen as unacceptable. <p>Therefore we have determined that this is not a significant risk for Southwark Council.</p>	<p>Our audit work has not identified any issues in respect of revenue recognition.</p>
<p>Property, Plant and Equipment (PPE)</p> <p>Property, plant and equipment activity not valid</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> • documented our understanding of processes and key controls over the transaction cycle • undertaken walkthrough of the key controls to assess the whether those controls were in line with our documented understanding • completed substantive testing of the entries included within the PPE notes • reviewed the capital programme against the additions recorded in the asset register in the financial year, including testing on a sample basis 	<p>During our testing we identified one property, with a value of £1.96m, which had been disposed in-year but remained in the Asset Register and the Accounts at year end. We have performed further work to confirm that this issue is isolated. Due to the fact that this item is immaterial, the Council are not proposing to amend, and this was reported as an unadjusted misstatement in our Audit Findings Report</p> <p>No other issues were identified from the work performed in respect of the risk identified.</p>

Audit of the accounts - Council

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Property, Plant and Equipment</p> <p>Revaluation measurements not correct</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> • documented our understanding of processes and key controls over the transaction cycle • undertaken walkthrough of the key controls to assess the whether those controls were in line with our documented understanding • reconciled the valuation report to the asset register and the accounts • reviewed the competence, expertise and objectivity of management's experts • reviewed the work performed by the valuer, including ensuring that any valuations have been undertaken in accordance with the requirements of the appropriate accounting and professional standards • reviewed and challenged the data used by the valuer to ensure that it is complete, robust and consistent with our understanding 	<p>No significant issues were identified from the work performed in respect of the risk identified.</p>
<p>Employee Remuneration</p> <p>Payroll expenditure represents a significant percentage of the Council's gross expenditure.</p> <p>We identified the completeness of payroll expenditure in the financial statements as a risk requiring particular audit attention:</p> <ul style="list-style-type: none"> • Employee remuneration accruals understated (Remuneration expenses not correct) 	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> • documented our understanding of processes and key controls over the transaction cycle • undertaken walkthrough of the key controls to assess the whether those controls were in line with our documented understanding • tested a sample of revenue expenditure items across the whole financial year back to supporting documentation • tested unrecorded liabilities to confirm the completeness and cut off of transactions included within the Accounts 	<p>Our audit work has not identified any significant issues in relation to the risk identified.</p> <p>As mentioned in the Executive Summary in our Audit Findings Report, a recommendation was raised around ensuring sufficient documentation is in place for casual workers engaged by the Council.</p>

Audit of the accounts – Pension Fund

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work on the audit of the Pension Fund.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Investments portfolio</p> <p>Level 3 indirect property investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> walkthrough tests of controls on investments for Brockton and Frogmore indirect properties, we tested valuations by obtaining and reviewing audited accounts at the latest date for individual investments and agreeing these to the fund manager reports at that date. Reconciliation of those values to the values at 31st March with reference to known movements in the intervening period. 	<p>Our audit work did not identify any significant issues in relation to the risk identified.</p>
<p>Contributions</p> <p>Recorded contributions not correct (Occurrence)</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> We have performed a walkthrough to gain assurance that the in-year controls were operating in accordance with our documented understanding. Tested a sample of contributions to source data to gain assurance over their accuracy and occurrence. Rationalised contributions received with reference to changes in member body payrolls and numbers of contributing pensioners and ensured that any unexpected trends were satisfactorily explained. 	<p>Our audit work did not identify any significant issues in relation to the risk identified.</p> <p>However, testing identified that some contributions from scheduled and admitted bodies were received by the Fund after the deadline of 19 days after month end in March 2017. The delays are due in part to the contributions still being paid in to the Council's bank account and then transferred to the Fund's bank account. This method is not in line with the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 and remains an area of non compliance.</p>

Audit of the accounts – Pension Fund

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work on the audit of the Pension Fund.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Benefits Payable</p> <p>Benefits improperly computed/claims liability understated (Completeness, accuracy and occurrence)</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> • We performed a walkthrough to gain assurance that the in-year controls were operating in accordance with our documented understanding. • Controls testing over, completeness, accuracy and occurrence of benefit payments, • Tested a sample of individual pensions in payment by reference to member files. • Rationalised pensions paid with reference to changes in pensioner numbers and increases applied in the year and ensured that any unusual trends were satisfactorily explained. 	<p>Our audit work did not identify any significant issues in relation to the risk identified. However, our testing identified one case where documents were not retained from employee confirming there election rights of pension to be paid. Documents need to be available for review in case of any queries from pensioner at a later date.</p> <p>In addition, the fund has not circulated pensioners domiciled abroad to confirm that they are still eligible. This was a recommendation in the prior year and action has not been taken this year.</p>
<p>Member Data</p> <p>Member data not correct. (Rights and Obligations)</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> • We performed a walkthrough to gain assurance that the in-year controls were operating in accordance with our documented understanding. • Controls testing over annual/monthly reconciliations and verifications with individual members. • Sample tested changes to member data made during the year to source documentation. 	<p>Our audit work identified a number of issues in the member data testing in 2016/17:</p> <ul style="list-style-type: none"> • 1 case was identified where the admitted bodies had not provided starter information and the pensions team had to estimate the start date from the schedule of contributions. Also there was also no evidence to show if statutory notification was sent to these individuals; • 3 cases were identified where the leavers date was not provided. <p>We have obtained assurance that the financial statements are materially fairly stated. However, we made a recommendation to management that membership data needed to be reviewed before the next triennial valuation is due to ensure the information provided to the actuary is complete and accurate. The Council engaged the actuary to carry out a review of information. We are currently awaiting this report to reach a conclusion for our audit and make a recommendation for this audit report.</p>

Audit of the accounts

Audit opinion

We gave an unqualified opinion on the Council's accounts on 28 September 2017, in advance of the 30 September 2017 national deadline.

The Council made the accounts available for audit in line with the agreed timetable, and provided a good set of supporting working papers. The finance team responded promptly and efficiently to our queries during the audit. However some of the detailed samples took longer to be collated than expected, and there were particular challenges in obtaining audit evidence from HR, as has been the case in previous years. We recognise a new Head of HR has been in post since October and we look forward to working with them to resolve these issues ahead of next year's move in the deadline to 31 July 2018.

Issues arising from the audit of the accounts

We reported the key issues from our audit of the accounts of the Council to the Council's Audit, Governance and Standards Committee on 13 September 2017.

We identified one unadjusted misstatement, which arose when a Property, Plant and Equipment (PPE) Asset disposed during the course of the year had not been removed from the PPE Register and thus remained in the Accounts at year end. The Council did not adjust for this issue due to it not being material to the overall financial statements, and also due to the complexity of the adjustments required.

We also identified several presentation and disclosure issues that were amended for in the Council's final financial accounts.

Annual Governance Statement and Narrative Report

We are 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 and with our knowledge of the Council.

Whole of Government Accounts (WGA)

We carried out work on the Council's consolidation schedule in line with instructions provided by the NAO . We issued a group assurance certificate which did not identify any issues for the group auditor to consider on 29 September 2017.

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.

We received an objection from a local elector relating to some of the Investments held by the Pension Fund. At the date of issuing this Letter we are still considering this objection, and will update the Council once we are in a position to conclude our work in this area.

As a result we are unable to certify the completion of the audit until we have finished our consideration of this objection.

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 2016 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 risk we identified and the work performed is set out in table 2 overleaf.

As part of our Audit Findings Report we highlighted that the Council has more to do to make sure that it has its spending on Adults and Children's Social Care under control to ensure this does not continue to have an adverse impact on the Council's overall financial stability.

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 2017.

Value for Money

Table 2: Value for money risks

Risk identified	Work carried out	Findings and conclusions
<p>Financial Performance The Council is facing significant financial pressures, particularly in relation to Social Care Budgets. We will consider the arrangements that are being put in place to secure a sustainable financial future for the Council.</p>	<p>We performed the following work in this area:</p> <ul style="list-style-type: none"> • review the 2016-17 Outturn, including details of performance against both the Revenue and Capital Budgets; • review progress against the 2017-18 financial plan up to the completion of our audit; and • obtain an update on the Council's Medium Term Financial Strategy, including progress on identifying the savings required in coming years including discussions with Management on progress to date. 	<p>The key points from our work in this area are as follows:</p> <ul style="list-style-type: none"> • The Council delivered a balanced General Fund position at the end of 2016-17, however this relied on the use of £27.4m of Reserves, which the Council is clear is not going to be sustainable given their current position and the pressures on Local Government financing going forward. • In terms of the reasons behind this large demand on Reserves during 2016-17, the main area of concern was Children's and Adult Social Care, which overspent its budget by £14.887m, which was after the use of £11.45m of Reserves, which in effect means these services were overspent by £26.3m, which equates to 15.36% of the original budget of £171.5m. This is on top of the £18.7m budget pressure which the Council had to manage in 2015-16, so it is clear this service is generating a significant pressure on the overall financial position of the Council. • Given the challenges which have been faced in this area over recent years, the Council has taken action by engaging RSM Tenon to undertake a review of the arrangements in place. They have also set up a Budget Recovery Board, which meets on a fortnightly basis to monitor the progress against budget in this area closely to ensure in-year overspends are identified and dealt with in a timely manner. • Other areas which were a challenge for the Council during the course of 2016-17 include the number of cases picked up under the No Recourse to Public Funds, which has come in over £3.7m above Budget. ICT Modernisation was another area which had a negative impact on the overall financial position, with £1.4m of exceptional costs (after drawdown) occurring across this area and Facilities Management, which have been long standing issues for the Council, which are likely to remain the case over the short term. • A balanced budget has been set for 2017-18, delivery of which will require savings and income generation schemes totalling £26.4m to be achieved during the course of the year. All of these schemes were identified in advance of 2017-18, set across all of the Council's Departments. We have reviewed the assumptions underlying this budget and are satisfied that they are reasonable given the Council's circumstances. These assumptions include a 4.99% increase in Council Tax in 2017-18, including the Adult Social Care Precept, along with allowances for increases in pay and other areas such as contracts. • As part of the 2017-18 Budget, the Council is allowing for a further £13m increase in spending on Social Care, which seems appropriate given the challenges which have been faced over the past two years. However this will need careful monitoring and management to ensure that these increases do not slip and have an impact on the savings plans which the Council has already identified. • Looking longer term, the Council's latest Medium Term Financial Plan covers the period up to 2018/19, which is largely due to the level of uncertainty around Local Government financing post-2020, which is when the new Local Government funding settlement is going to be implemented. At the moment the Council is struggling to come up with plans post this period, and thus they will need to monitor progress closely as 2020 gets closer to ensure they are well placed to react to the revised plans. <p>Overall, it is clear that the Council needs to ensure its Social Care spending is under control to ensure it is a strong position ahead of the challenges that 2020 is likely to bring for all Local Authorities. Whilst steps have been taken, it is clear there is still more for the Council to do in this area to have this completely under control.</p>

Appendix A: Reports issued and fees

We confirm below our final fees charged for the audit and the provision of non-audit services.

Fees

	Proposed fee £	Final fee £
Council audit	237,296	237,296
Grant Certification	23,018	TBC
Total audit fees (excluding VAT)	260,314	TBC

The proposed fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA)

Grant certification

Our fees for grant certification cover only housing benefit subsidy certification, which falls under the remit of Public Sector Audit Appointments Limited. Fees in respect of other grant work, such as reasonable assurance reports, would be shown under 'Fees for other services', but there are no items of this type to be considered in 2016-17.

Our final fee for this work will only be confirmed once we have completed all of the work required by this certification, which will be completed by the end of November 2017, which is the national deadline for the completion of this work.

Reports issued

Report	Date issued
Audit Plan	February 2017
Audit Findings Report	13 September 2017
Annual Audit Letter	18 October 2017

Fees for other services

Service	Fees £
Audit related services:	
• Teachers' Pensions Certification	4,500
• Pooling of Housing Capital Receipt Certification	4,500
Non-audit services:	
• Financial Resilience – Capacity Building Programme	3,500
• Cost Assurance	43,959
• CFO Insights Subscription	10,000

Non-audit services

- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The table above summarises all other services which were identified.
- We have considered whether other services might be perceived as a threat to our independence as the Council's auditor and have ensured that appropriate safeguards are put in place, as reported in our Audit Findings Report.

Reports issued and fees continued

We have considered whether other services might be perceived as a threat to our independence as the Council's auditor and have ensured that appropriate safeguards have been applied to mitigate these risks.

	Service provided to Southwark Council	Fees (£)	Threat?	Safeguard
Audit related services	Teachers' Pensions Certification	4,500	No	Fee is low in comparison to the Council's audit fee. A separate independent engagement is performed and a report will be given in line with a separate engagement letter.
	Pooling of Housing Capital Receipt Certification	4,500	No	Fee is low in comparison to the Council's audit fee. A separate independent engagement is performed and a report will be given in line with a separate engagement letter.
Non-audit services	Financial Resilience – Capacity Building Programme	3,500	No	Fee is low in comparison to the Council's audit fee. This work is merely training delivered to the Council's finance team by Grant Thornton colleagues who are not involved in the external audit of the Council.
	Cost Assurance	43,959	No	Whilst this fee is significant, this work is performed by a separate engagement team who are completely independent from the external audit team to reduce the risk.
	CFO Insights Subscription	10,000	No	Fee is low in comparison to the Council's audit fee. This work entails us providing the Council with information about the Council's position in relation to its peers and has no impact on the Council's financial statements or our audit.
	TOTAL	66,459		

The above non-audit services are consistent with the Council's policy on the allotment of non-audit work to your auditor and have been approved by the Audit, Governance and Standards Committee.



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