



# Annual Audit Letter

*Year ending 31 March 2018*

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**Southwark Council**

30 August 2018



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# Executive Summary

## Purpose

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 2018.

This Letter is intended to provide a commentary on the results of our work to the Council and 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 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 18 July 2018.

## Our work

## Respective 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) (ISAs) and other guidance issued by the NAO.

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<b>Materiality</b>	We determined materiality for the audit of the Council's financial statements to be £25,000,000, which is 2% of the Council's gross revenue expenditure. We determined materiality for the audit of the pension fund accounts administered by the Council to be £15,000,000, which is 0.98% of the pension fund's net assets.
<b>Financial Statements opinion</b>	We gave an unqualified opinion on the Council's financial statements on 31 July 2018. We gave an unqualified opinion on the pension fund accounts of the Southwark Council Pension Fund on 31 July 2018.
<b>Whole of Government Accounts (WGA)</b>	We completed work on the Council's consolidation return following guidance issued by the NAO.
<b>Use of statutory powers</b>	We did not identify any matters which required us to exercise our additional statutory powers.

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# Executive Summary

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## Value for Money arrangements

We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Council on 31 July 2018.

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## 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 2018. We will report the results of this work to the Audit, Governance and Standards Committee in our Annual Certification Letter.

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## Certificate

We certify that we have completed the audit of the accounts of Southwark Council in accordance with the requirements of the Code of Audit Practice.

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## Working with the Council

During the year we have delivered a number of successful outcomes with you:

- An efficient audit – we delivered an efficient audit with you in June and July, delivering the accounts in almost half the time we spent last year, in advance of the end of July deadline as well.
- Sharing our insight – we provided regular audit committee updates covering best practice. We also shared our thought leadership reports with Management and the Audit, Governance and Standards Committee.
- Providing training – we provided your teams with training and support on the accounts throughout the course of the year.

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**  
August 2018

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# Audit of the Accounts

## Our audit approach

### Materiality

In our audit of the Council's financial statements, 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 the audit of the Council's accounts to be £25,000,000, which is 2% of the Council's gross revenue expenditure. We used this benchmark as, in our view, users of the Council's financial statements are most interested in where the Council has spent its revenue in the year.

We set a lower threshold of £1,250,000, above which we reported errors to the Audit, Governance and Standards Committee in our Audit Findings Report.

### Pension Fund Materiality

For the audit of the Southwark Council Pension Fund accounts, we determined materiality to be £15,000,000, which is 0.98% 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 threshold of £750,000 above which we reported errors to the Audit, Governance and Standards Committee.

### The scope of our audit

Our audit involves obtaining sufficient 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 accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the 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 remainder of the Statement of Accounts and the Annual Governance Statement published alongside the Statement of Accounts to check they are consistent with our understanding of the Council and with the financial statements included in the Statement of Accounts on which we gave our opinion.

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

Our audit approach is 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

## Significant Audit Risks

These are the significant 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><b>Improper revenue recognition</b> Under ISA 240 (UK) 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 the Council, we determined that the risk of fraud arising from revenue recognition could be rebutted, because:</p> <ul style="list-style-type: none"> <li>• there is little incentive to manipulate revenue recognition</li> <li>• opportunities to manipulate revenue recognition are very limited</li> <li>• The culture and ethical frameworks of local authorities, including Southwark Council, mean that all forms of fraud are seen as unacceptable</li> </ul> <p>Therefore we did not consider this to be a significant risk for Southwark Council.</p> <p>However as Revenue is a material balance for the Council, we performed the following:</p> <ul style="list-style-type: none"> <li>• reviewed and tested the Council's revenue recognition policies</li> <li>• performed testing on material revenue streams</li> </ul>	<p>Our audit work did not identify any issues in respect of improper revenue recognition.</p>
<p><b>Management override of controls</b> Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management override of controls is present in all entities.</p> <p>We identified management override of controls as a risk requiring special audit consideration.</p>	<p>As part of our audit work we completed the following:</p> <ul style="list-style-type: none"> <li>• gained an understanding of the accounting estimates, judgements applied and decisions made by management and considered their reasonableness;</li> <li>• obtained a full listing of journal entries, identified and tested unusual journal entries for appropriateness; and</li> <li>• evaluated the rationale for any changes in accounting policies or significant unusual transactions.</li> </ul>	<p>Our audit work did not identify any issues in respect of management override of controls.</p>

# Audit of the Accounts

## Significant Audit Risks

These are the significant 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><b>Valuation of property, plant and equipment</b> The Council revalues its land and buildings on an quinquennial basis to ensure that carrying value is not materially different from fair value. This represents a significant estimate by management in the financial statements.</p> <p>We identified the valuation of land and buildings revaluations and impairments as a risk requiring special audit consideration.</p>	<p>As part of our audit work we completed the following:</p> <ul style="list-style-type: none"> <li>• reviewed management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work;</li> <li>• considered the competence, expertise and objectivity of any management experts used;</li> <li>• discussed with the valuer the basis on which the valuation is carried out and challenge the key assumptions;</li> <li>• reviewed and challenged the information used by the valuer to ensure it is robust and consistent with our understanding;</li> <li>• tested revaluations made during the year to ensure they are input correctly into the Council's asset register; and</li> <li>• evaluated the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value.</li> </ul>	<p>Our audit work identified that when testing the allocation of PPE Revaluations, the Council identified that whilst the net impact on the CIES was correct, the movements up and down were incorrect. These were subsequently revisited by the Council, and adjusted within the revised Accounts.</p>
<p><b>Valuation of pension fund net liability</b> The Council's pension fund asset and liability as reflected in its balance sheet represents a significant estimate in the financial statements.</p> <p>We identified the valuation of the pension fund net liability as a risk requiring special audit consideration.</p>	<p>As part of our audit work we completed the following:</p> <ul style="list-style-type: none"> <li>• identified the controls put in place by management to ensure that the pension fund liability is not materially misstated. We have also assessed whether these controls were implemented as expected and whether they are sufficient to mitigate the risk of material misstatement;</li> <li>• evaluated the competence, expertise and objectivity of the actuary who carried out your pension fund valuation;</li> <li>• gained an understanding of the basis on which the valuation is carried out;</li> <li>• undertaken procedures to confirm the reasonableness of the actuarial assumptions made; and</li> <li>• checked the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial report from your actuary.</li> </ul>	<p>Our audit work did not identify any issues in respect of the valuation of the pension fund net liability in the Accounts.</p>

# Audit of the Accounts – Pension Fund

## Pension Fund Significant Audit Risks

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>Improper revenue recognition</b></p> <p>Under ISA 240 (UK) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. 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 Pension Fund, we determined that the risk of fraud arising from revenue recognition could be rebutted, because:</p> <ul style="list-style-type: none"> <li>• there is little incentive to manipulate revenue recognition</li> <li>• opportunities to manipulate revenue recognition are very limited</li> <li>• The culture and ethical frameworks of local authorities, including Southwark Council Pension Fund, mean that all forms of fraud are seen as unacceptable</li> </ul> <p>Therefore we did not consider this to be a significant risk for Southwark Council Pension Fund.</p>	<p>Our audit work did not identify any issues in respect of improper revenue recognition.</p>
<p><b>Management override of controls</b></p> <p>Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management override of controls is present in all entities.</p> <p>We identified management override of controls as a risk requiring special audit consideration.</p>	<p>As part of our audit work we completed the following:</p> <ul style="list-style-type: none"> <li>• gained an understanding of the accounting estimates, judgements applied and decisions made by management and consider their reasonableness</li> <li>• obtained a full listing of journal entries, identified and tested unusual journal entries for appropriateness</li> <li>• evaluated the rationale for any changes in accounting policies or significant unusual transactions.</li> </ul>	<p>Our audit work did not identify any issues in respect of management override of controls.</p>

# Audit of the Accounts – Pension Fund

## Pension Fund Significant Audit Risks

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

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>The valuation of Level 3 (Hard to Value) investments is incorrect</b></p> <p>Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.</p> <p>We identified the valuation of level 3 investments as a risk requiring special audit consideration.</p> <p><b>NB: for Southwark Pension Fund, its Level 3 Investments are Freehold and Leasehold Properties.</b></p>	<p>As part of our audit work we completed the following:</p> <ul style="list-style-type: none"> <li>gained an understanding of the Fund’s process for valuing level 3 investments and evaluated the design of the associated controls</li> <li>reviewed the nature and basis of estimated values and considered what assurance management has over the year end valuations provided for these types of investments</li> <li>consideration of the competence, expertise and objectivity of any management experts used</li> <li>reviewed the qualifications of the Fund Managers to value Level 3 investments at year end and gained an understanding of how the valuation of these investments has been reached</li> <li>for a sample of investments, tested the valuation by obtaining and reviewing the audited accounts, (where available) at the latest date for individual investments and agreeing these to the fund manager reports at that date. We also reconciled those values to the values at 31 March 2018 with reference to known movements in the intervening period</li> </ul>	<p>Our audit work did not identify any issues in respect of the valuation of the Level 3 Investments in the Accounts.</p>

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# Audit of the Accounts

## **Audit opinion**

We gave an unqualified opinion on the Council's financial statements on 31 July 2018, in line with the national deadline.

## **Preparation of the accounts**

The Council presented us with draft accounts in accordance with the national deadline, 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.

## **Issues arising from the audit of the accounts**

We reported the key issues from our audit to the Council's Audit, Governance and Standards Committee on 18 July 2018.

We identified two adjustments to the core Financial Statements, along with a number of presentation and disclosure amendments, all of which were processed by the Council within the final set of 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 alongside the Statement of Accounts in line with the national deadlines.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Council and with our knowledge of the Council.

## **Whole of Government Accounts (WGA)**

We carried out work on the Council's Data Collection Tool in line with instructions provided by the NAO. We issued an assurance statement which did not identify any issues for the group auditor to consider on 22 August 2018.

## **Pension fund accounts**

We gave an unqualified opinion on the pension fund accounts of the Southwark Council Pension Fund on 31 July 2018.

We also reported the key issues from our audit of the pension fund accounts to the Council's Audit, Governance and Standards Committee on 18 July 2018.

## **Certificate of closure of the audit**

We are also required to certify that we have completed the audit of the accounts of Southwark Council in accordance with the requirements of the Code of Audit Practice. We certified the Council's audit as closed on the 30th of August 2018, following the completion of our work on the Council's Whole of Government Accounts Return as mentioned below.

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# Value for Money conclusion

## Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 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.

# Action plan

Assessment	Issue and risk	Recommendations
<p>①</p> <p>●</p> <p><b>Amber</b></p>	<p><b>Value for Money – future financial sustainability</b></p> <p>The Council needs to start looking ahead to 2020 onwards and ensure that both Officer and Members are on board with the challenges that the Council may potentially face from this period onwards</p>	<p>The Council needs to start undertaking work to consider the environment post-2020 so it will be able to deal with the challenges that may be faced from this date.</p> <p><b>Management response</b></p> <p>Agreed – however, the considerable uncertainty regarding the future funding of local authorities beyond 2020 (Comprehensive Spending Review, Fair Funding Review, Business Rates Retention and future funding of Adult Social Care) makes strategic financial planning particularly challenging.</p>
<p>②</p> <p>●</p> <p><b>Amber</b></p>	<p><b>Value for Money – Dedicated Schools Grant</b></p> <p>The Council encountered considerable challenges on spending normally covered via the Dedicated Schools Grant, due to challenges around those children with High Needs and Special Needs. These overspends are not sustainable over the Medium Term if spending in these areas cannot be brought back under control.</p>	<p>The Council needs to continue with the work in this area to ensure that budgets are closely managed and overspends challenged and dealt with to ensure this doesn't continue to have an adverse impact on the Council's overall financial position.</p> <p><b>Management response</b></p> <p>Agreed – the 2017-18 revenue outturn position evidenced the Council's robust financial management arrangements, including the work of the budget recovery board. This rigour will continue to be applied to ensure that spending pressures are managed and budgets are sustainable.</p>

The key risk we identified and the work we performed is set out overleaf.

As part of our Audit Findings Report agreed with the Council in July 2018, we agreed recommendations to address our findings, which are shown below, along with Management's Response to these

## Overall Value for Money 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 2018.

# Value for Money conclusion

## Key Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p><b>Ongoing Financial Performance</b></p> <p>The Council is continuing to face pressure on its Social Care Budgets, and other factors such as the demand for temporary accommodation and the impact of nil resource to public funds are putting the Council's finances under considerable strain.</p> <p>Therefore the Council needs to manage its resources carefully to ensure a sustainable future for the Borough ahead of the 2020 Funding Settlement.</p>	<p>As part of our work we completed the following:</p> <ul style="list-style-type: none"> <li>• reviewed the 2017-18 Outturn, and progress against the 2018-19 financial plan up to the completion of our audit; and</li> <li>• obtained 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.</li> </ul>	<p>Our work in this area identified the following:</p> <ul style="list-style-type: none"> <li>• The Council delivered a balanced budget in 2017-18, which included the movement of <b>£10.799m</b> to General Fund Reserves to help strengthen the overall financial position of the Council. This helps to offset some of the <b>£27.4m</b> draw on reserves that took place in 2016-17, which was largely due to the challenges on Social Care, both in Adults and Children's. Other areas which continue to pose challenges for the Council include the demands on Nil Recourse to Public Funds, and Temporary Accommodations, although the Council is not alone in facing these challenges.</li> <li>• Significant improvements have been made in respect of Social Care, with the total overspend in this area arriving at <b>£2.4m</b> at the end of 2017-18, of which <b>£2.042m</b> related to Children's. This is clearly an area which the Council is going to need to continue to work on during 2018-19 and beyond, with a plan already in place to recoup the 2017-18 overspend in 2018-19.</li> <li>• A balanced budget has been set for 2018-19, which includes the delivery of <b>£18.209m</b> of further efficiencies and income to offset the shortfall in the budget. Plans are in place for the delivery of this sum, which will need close monitoring during the course of the year.</li> <li>• The Council is continuing to adopt a one-year planning timeframe due to the level of uncertainty post-2020, which is something that will need to be tackled soon to ensure the Council is in a position to face the challenges. Whilst we understand why the Council is taking this approach, it does leave them at risk if the new Local Government Funding Settlement does not deliver a positive outcome for the Council from 2020 onwards.</li> <li>• We also considered the Council's Reserves Positions, and noted that whilst the Council was in the middle of the pack on several metrics, it did perform poorly when considering the level of General Fund Reserves as a percentage of Gross Revenue Expenditure. This is something that the Council needs to continue to work to strengthen over the coming years so it is better placed to face the challenges ahead.</li> </ul> <p>Based on the work we performed to address the significant risk, we concluded that:</p> <ul style="list-style-type: none"> <li>• the Council had proper arrangements in all significant respects to ensure it delivered value for money in its use of resources.</li> </ul> <p>However as mentioned on the previous page, we have raised a couple of recommendations for the Council to consider, and we will monitor the progress in these areas over the course of the next 12 months ahead of next year's VfM Work.</p>

# A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit and provision of non-audit services as follows:

## Reports issued

Report	Date issued
Audit Plan	19 February 2018
Audit Findings Report	18 July 2018
Annual Audit Letter	30 August 2018

## Fees

	Planned £	Actual fees £	2016/17 fees £
Statutory Council audit	237,296	237,296	237,296
Audit of Pension Fund	21,000	21,000	21,000
Housing Benefit Grant Certification	17,717	TBC	17,717
<b>Total fees</b>	<b>276,013</b>	<b>[xx]</b>	<b>276,013</b>

The planned fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA). We will be unable to confirm our final fee for our Housing Benefit Work until we have completed the work ahead of the November 2018 deadline.

## Fees for non-audit services

Service	Fees £
<b>Audit related services:</b>	
• Certification of Housing Capital Receipts Grant	5,000
• Certification of Teachers Pensions Return	5,000
<b>Non-audit services:</b>	
• 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 non-audit services which were identified.
- We have considered whether non-audit 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.

The above non-audit services are consistent with the Council's policy on the allotment of non-audit work to your auditor.



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