

# Annual Audit Letter

Southampton City Council

Audit 2008/09

December 2009



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## Status of our reports

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors/ members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

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

**This report summarises the findings from our 2008/09 audit. It includes messages arising from the audit of your financial statements and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources.**

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## Audit opinion and financial statements

- 1 I gave an unqualified opinion on the Council's accounts on 30 September 2009.
- 2 The financial statements provided for audit were of a good standard as were the working papers that supported them. There were no adjustments made to the financial statements during the audit that impacted upon the Council's financial position at 31 March 2009.
- 3 There were, however, some adjustments made to the supporting notes to the financial statements that we needed to report three of which were above the materiality level for the opinion of £15 million.
- 4 The audit of the 2007/08 financial statements was concluded and an audit certificate issued on 10 December 2009. I issued my decision, and supporting statement of reasons on the objection which was made to the 2007/08 financial statements in respect of charges to tenants for heating in council properties on 26 October 2009. I allowed the elector sufficient time to consider my decision and to apply to the courts before issuing my certificate of closure of the audit. I am also in the process of responding to similar issues raised by another elector in respect of the 2008/09 financial statements.

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## Value for money

- 5 I issued an unqualified value for money conclusion on 30 September 2009 stating that "I am satisfied that, in all significant respects, Southampton City Council made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2009".
- 6 In my Use of Resources assessment, I concluded that the Council scored 3 out of a maximum of 4. This is a creditable achievement when set against the rigours of the new framework that has been set by the Audit Commission, the challenging financial pressures and increasing demand for services arising from the worsening economic climate.
- 7 Our assessment benefited from the Council's identification of outcomes from service improvements and delivery which is a key feature of the new assessment framework. We recognise that the Council is addressing the areas that had previously been identified for improvement, for example the need for a new charging policy and income billing system for social care.

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## Actions

- 8 My audit has confirmed the need for the Council to sustain its impetus to deliver its priorities in the following areas.
- Remain focussed on service prioritisation, efficiencies and identifying savings within its budget setting process to enable the Council to preserve its sound financial standing in the medium term.
  - The implementation of the strategic developments that are being delivered in response to corporate priorities, through for example the Building Schools for the Future programme, the Highways Maintenance Partnership, the South Coast Street Lighting PFI and Estates Regeneration as these are key areas in which the Council is seeking to improve outcomes for local people and to improve value for money.
  - Continue to address education performance where, despite improvements over the last year, educational attainment is still below that of similar councils and costs are higher.
  - Implement the planned installation of individual electricity supply meters to the tenanted and leasehold properties, including the initial 600 meters by 31 March 2010, so that charges can be accurately calculated for each individual property.
- 9 The Council is already taking these areas forward during 2009/10.

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## Independence

- 10 I can confirm that the audit has been carried out in accordance with the Audit Commission's policies on integrity, objectivity and independence.

# Financial statements and annual governance statement

**The Council's financial statements and annual governance statement are an important means by which the Council accounts for its stewardship of public funds.**

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## Significant issues arising from the audit

- 11 I was able to give an unqualified opinion on the Council's financial statements on 30 September 2009.
- 12 In planning my audit, I identified a number of potential risk areas and was pleased to find that the Council had appropriately addressed each of these and that there was nothing I needed to report. The risks I identified included considering whether the Council had established a provision or contingent liability for equal pay claims and staff redundancies; correctly accounted for a number of potentially significant capital accounting transactions; addressed the weaknesses that had previously been identified in the reconciliation between the social care income and Agresso systems; and responded to the changes required by the 2008/09 Statement of Recommended Practice for local authority accounting.
- 13 Our overall materiality level for the opinion audit at Southampton City Council was set at £15m in line with guidance issued by the Audit Commission and International Auditing Standards. With this overall level of materiality the level of error for reporting to those charged with governance was set at £150,000.
- 14 The majority of items which we raised during the audit related to the way things were presented in the supporting notes to the accounts. The adjustments that were identified had no impact on the Council's financial position at 31 March 2009 or the prime financial statements.
- 15 Some amendments were made to the supporting notes to the accounts that were above our materiality level.
  - The carrying value of financial liabilities within note 33 to the financial statements had been understated by £33.2 million. The correct value was £133.3 million.
  - The estimated contributions expected to be paid by the Council to the Pension Fund in 2009/10 of £16.4 million had been omitted from note 44.
  - The removal of the major repairs allowance from note 58 (Capital Grants and Contributions Unapplied) by reducing the debit entries by £12.2 million and the credit entries by a similar amount. The Capital Expenditure and Financing Statement was also amended in order to separately disclose the major repairs allowance.

- 16 There were two other errors which we reported but which were below our materiality level that were also amended and there were some more minor changes agreed with officers to the wording of the accounting policies and notes to the financial statements.

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### Material weaknesses in internal control

- 17 I did not identify any significant weaknesses in your internal control arrangements during my 2008/09 audit.

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### Accounting Practice and financial reporting

- 18 I considered the qualitative aspects of your financial reporting and have no issues that I need to raise with you.

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### Formal audit powers and correspondence with electors

- 19 I have previously reported that I had received a formal objection from an elector in relation to the Council's 2007/08 financial statements and that I had also received further information that has been brought to my attention by a second elector in relation to the 2008/09 financial statements.

### Objection to the 2007/08 accounts

- 20 The formal objection to the 2007/08 accounts was concerned with the heating charges made to tenants by the Council. The electricity used to heat those Council flats that are on the communal heating system is recorded through a number of meters predominantly situated on the ground floor of a block of flats. These record the amount of electricity used to heat the flats within a block and do not record individuals' usage. The Council estimates the following year's total cost of operating the communal heating system by estimating usage (based on the previous year's figure); including any known changes in contract rates and then comparing this with the level of income being received through tenant charges. Any variance is reduced by applying an increase or decrease percentage to the previous year's tenant charge to enable the full recovery of estimated costs. If an over or under recovery is made in one year this is then built into the calculation for the following year.
- 21 The Council was aware that its old system of calculating the charge to individual tenants may not have been the most appropriate method and a new methodology has been introduced to calculate the individual heating charge based on the floor area of the property. The Council also has plans to complete the installation of approximately 600 individual meters by the end of March 2010.
- 22 In summary, the elector contended that:
- the Council in its capacity as a landlord is engaged in the unlawful resale of electricity and gas to its tenants because it is not complying with its responsibilities as a landlord under guidance issued by Ofgem;

## Financial statements and annual governance statement

- the Council as a landlord is engaged in unlawful Housing Benefit administration because if tenants heating charges have been over or understated then the calculation of each claimant's housing benefit entitlement would also be over or understated;
  - the Council is breaking local government rules in allowing money in the ring fenced Housing Revenue Account to be used to subsidise right to buy leaseholders; and
  - the Council is failing to comply with government guidance on social rent reform by not correctly calculating the formula rent.
- 23** The elector asked me to consider making an application to the courts under section 17 of the Audit Commission Act 1998 because he believed the items of account relating to the above were contrary to law.
- 24** Having received written submissions from the elector and the Council, made the further enquiries which I considered necessary, and taken my own legal advice I have decided not to apply to the courts for a declaration that there is an item of account which is contrary to law. This is because in my view there is no item of account that is contrary to law. I also considered whether there were any matters arising which should be the subject of a report in the public interest. I concluded this was not necessary because:
- it does not appear to me that there is an item account which is contrary to law;
  - there has been widespread coverage of this issue in the local media and via public meetings and forums and I do not think that a public interest report would add anything in informing the public further; and
  - the Council is continuing to make improvements in its method of calculating recharges and is installing new meters to record actual energy consumption.
- 25** My decision was issued on 26 October 2009. The elector has a statutory right of appeal to the court against my decision not to make an application to the courts for a declaration that there is an item of account which is contrary to law. Any such appeal would have needed to be made within 28 days of the date of my decision and statement of reasons. Now that that time has expired I have closed the audit of the 2007/08 financial statements and issued the audit closure certificate on 10 December 2009.
- 26** The key issue underpinning this objection is that there remain properties on the communal heating system which do not have individual electricity supply meters. I will be following the progress made by the Council towards the installation of individual meters for tenanted and leasehold properties and, in particular its intention to complete the installation of the first 600 meters by the end of March 2010.
- 27** Two other issues have come to my attention as I considered this objection which I raise for Members' attention in the period before the Council is able to install individual meters for all properties.
- The method of apportionment of electricity charges for heating costs which the Council uses is different for tenants and leaseholders. I would urge the Council to consider whether this continues to be appropriate.

- The Ofgem guidance on the resale of Gas and Electricity allows the recharge of administration costs but suggests that such costs should be shown separately from the electricity costs. I would urge the Council to consider whether it can amend its systems to show the administration charge as a separate element of the service charge for heating in the tenant rental agreements.

### Information received from an elector in respect of the 2008/09 accounts

28 I have also received correspondence from another elector about the accuracy of the total sum which is then apportioned in heating charges to tenants by the Council. I am currently treating this correspondence as matters that have been brought to my attention during my audit of the 2008/09 financial statements. I have been able to refer to my earlier correspondence with the Council in relation to heating charges but there are a number of detailed points which I have referred to your officers. Once I have their response I will be able to decide whether there are any matters relevant to my formal powers. The audit of the 2008/09 financial statements cannot be closed until I have concluded my review.

# Value for money and use of resources

**I considered how well the Council is managing and using its resources to deliver value for money and better and sustainable outcomes for local people, and gave a scored use of resources judgement.**

**I also assessed whether the Council put in place adequate corporate arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money (VFM) conclusion.**

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## Use of resources judgements

- 29** The new UoR assessment framework is more demanding than the previous assessment. It is broader in scope and embraces wider resource issues such as people and workforce planning, and the use of natural resources. It also places more emphasis on considering outcomes for local people. It is particularly important to recognise that the Key Line of Enquiry (KLOE) are more strategic and focus much more explicitly than previously on value for money achievements than on processes.
- 30** I have also taken into account, where appropriate, findings from previous use of resources assessments (updating these for any changes or improvements) and any other relevant audit work.
- 31** In forming my scored use of resources judgements, I have used the methodology set out in the [use of resources framework](#). Judgements have been made for each key line of enquiry (KLOE) using the Audit Commission's current four point scale from 1 to 4, with 4 being the highest.

- 32 The use of resources scores for the Council are shown in Table 1 below. I have previously issued the detailed findings from my assessment within the Annual Governance Report for 2008/09 which I presented to the Standards and Governance Committee on 24 September 2009.

**Table 1 Use of resources scores**

	<b>Council</b>
<b>Use of resources theme</b>	<b>Scored judgement</b>
<b>Managing finances</b>	<b>3</b>
KLOE 1.1 - Does the organisation plan its finances effectively to deliver its strategic priorities and secure sound financial health?	3
KLOE 1.2 Does the organisation have a sound understanding of its costs and performance and achieve efficiencies in its activities?	3
KLOE 1.3 - Is the organisations financial reporting timely, reliable and does it meet the needs of internal users, stakeholders and local people?	3
<b>Governing the business</b>	<b>3</b>
KLOE 2.1 - Does the organisation commission and procure quality services and supplies, tailored to local needs, to deliver sustainable outcomes and value for money?	3
KLOE 2.2 - Does the organisation produce relevant and reliable data and information to support decision-making and manage performance?	3
KLOE 2.3 - Does the organisation promote and demonstrate the principles and values of good governance?	3
KLOE 2.4 - Does the organisation manage its risks and maintain a sound system of internal control?	3
<b>Managing resources</b>	<b>3</b>
KLOE 3.1 - Is the organisation making effective use of natural resources?	3
KLOE 3.2 - Does the organisation manage assets effectively to help deliver its strategic priorities and service needs?	3
KLOE 3.3 - Does the organisation plan, organise and develop its workforce effectively to support the achievement of its strategic priorities?	Not applicable in 2008/09

### Overall conclusion

- 33 The Use of Resources scores that have been achieved by the Council are commendable, particularly when set in the context of the increased rigour that has been built into the new assessment framework by the Audit Commission. The Council has continued to demonstrate commitment to the development of its services for the benefit of service users, while dealing with a number of challenging financial pressures and increasing service demands arising through the worsening economic outlook.

## Value for money and use of resources

- 34 A key element of the new assessment framework is the identification of outcomes for users from services and service developments. Your officers have assisted our work by evidencing the efficient and effective use of resources by the Council through the identification of outcomes. This has been particularly important in relation to the areas that we have assessed for the first time during this review, namely the 'use of natural resources' (KLOE 3.1) and 'strategic asset management' (KLOE 3.2).
- 35 We have also concluded that the Council has addressed the key areas that have been highlighted within our previous assessments, for example the need for a new charging policy in relation to social care billing and a replacement social care billing system which is planned to be implemented during 2009/10.

## Managing finances

- 36 The Council plans its finances effectively to deliver its priorities and secure sound financial health. Integration of service and financial planning has enabled it to ensure that financial planning is driven by corporate policies and priorities. The Medium Term Financial Strategy reflects the Council's objectives and is used to challenge resource allocation and to explore ways of delivering priorities, efficiencies and value for money.
- 37 There is pro-active engagement with stakeholders through the budget setting process and the Council has effective budgetary reporting arrangements. Financial standing is sound, and this supports the achievement of long term objectives. There is a culture of transparency about the financial position of the Council which is encouraged by the financial leadership across the Council.
- 38 The economic downturn and banking crisis is having a very significant impact on public finances and the bodies that manage them. This has an impact on my audit and as part of my responsibility I have reflected on the wider environment, specific issues and risks, and the Council's response.
- 39 The impact of the banking crisis on treasury management strategies in the public sector has been immediate. Although not having investments in Icelandic Banks, the Council has reviewed its Treasury Management arrangements in response to the wider economic climate and in my view these are sufficient and robust.
- 40 There are wider and more fundamental impacts on the ability of public sector bodies to fund service delivery and capital programmes, including pressures on income streams and increasing demands made for the services. These have already been experienced by the Council in 2008/09, but it managed its general fund revenue expenditure within its revised budget and delivered a net general fund under spend of £7.1 million against the revised budget for 2008/09.
- 41 In my view the Council has sound financial planning processes in place that have enabled it to prioritise its services and make informed decisions over how it will close its budget gap over the next few years. This puts it in good stead, with a clear framework, to make any difficult decisions that may become necessary in the medium term.

- 42 The Council has a sound understanding of its costs and performance. It has good comparative information which has enabled delivery of £19 million efficiencies over three years. It achieves outcomes across a range of services while maintaining relatively low costs. Most higher cost services are performing well and delivering good outcomes. Although it has improved the service and lowered costs for educational attainment, there is still work to be done to demonstrate a track record in reduced costs and improved outputs for this service.
- 43 Financial reporting is timely, reliable and meets the needs of stakeholders. Internal financial monitoring is of a high standard. Financial information systems are accessible and provide tailored and useful information. External reporting is timely and provides an objective, balanced and understandable assessment of the Council's achievements and financial performance in the year and includes environmental and social information.

### Governing the business

- 44 The Council commissions and procures services to deliver sustainable outcomes and value for money. Its priorities have been developed through on-going involvement with stakeholders. A range of procurement options are taken into account and it has a good track record in identifying new ways of delivering services, which has led to improved access and value for money. Relations and performance with suppliers are managed well and it is developing improvements such as a sustainability policy to help combat climate change. The policy will encourage improvements in areas such as energy efficiency, air quality and renewable energy. For example, all new school buildings will need to meet strict environmental standards, and the new street lighting private finance initiative will result in eco-friendly lighting that emits less carbon.
- 45 The Council produces relevant and reliable information to support decision making and manage performance and works well with partners to ensure the quality of data. It ensures data security meets relevant statutory requirements and has security policies in place and performance management is integrated well with the management of resources. It has a good track record of achieving targets, making efficiency gains and identifying gaps for improvement.
- 46 The principles and values of good governance are promoted and demonstrated by the Council. It has robust procedures and practices in place, is well-governed with an open culture and a clear focus on the needs of communities. Leadership maintains focus on delivering the organisation's strategic priorities. The Council is regarded as an exemplar by other local authorities for its ethical framework and provides support and assistance to other Councils. It also ensures that each of its significant partnerships has an appropriate form of governance that is formally documented.
- 47 The Council manages its risks and maintains a sound system of internal control. Risk management is embedded in key business processes and the Council equips all members to undertake their roles and responsibilities for risk management. Effective risk management supports the Council in managing significant risks to deliver innovative and challenging projects. It has a well-publicised and comprehensive fraud and corruption policies and procedures and a sound system of internal control which provides for transparent governance reporting that is supported by internal audit and leads to a good quality Annual Governance Statement.

## Value for money and use of resources

### Managing resources

- 48 The Council makes effective use of natural resources. The baseline information that it has helps it understand the natural resources it consumes. It has a range of sustainable strategies, policies and targets in place and recognises the need to develop plans to reduce water use and raw materials and to embed sustainability impact assessments. It is reducing its use of natural resources and is on track to meet its targets for sustainability indicators. It has started to identify the risks that impact on its operations and the environmental impact of its suppliers.
- 49 The innovative district energy scheme which has helped the City minimise energy use is an example of how the Council works well with its partners. Other partnerships have resulted in developing sustainable schools and developing the region's sustainability policy. It funds an energy manager as part of a city-wide energy partnership, which ensures delivery of its action plan such as reducing CO2.
- 50 The Council manages its assets effectively to help deliver its strategic priorities and service needs. It has clear views on how landholdings should be used, why properties are owned and uses its property portfolio as an enabler of change. There is a well-managed capital programme linked to priorities and the Council understands the opportunity cost of its property and exploits this to deliver better value for money and benefits for the community. It challenges whether its assets are required, fit for purpose and provide value for money to meet current and future needs.
- 51 The Council has a number of key strategic developments that are in the process of being planned, delivered and implemented. These developments include for example preparations for the 'Building Schools for the Future' project that is being supported by the Partnership For Schools, the Highways Maintenance Public / Private Partnership that is being developed, the South Coast Street Lighting Public Finance Initiative and the ongoing Strategic Services Partnership.
- 52 Partnership working is developing with a strategic approach for assets used by public bodies across the City. It is integrating the management of its asset base with others to identify opportunities for shared use of property and is rationalising its own office occupation. The Council and the PCT share accommodation, bringing closer working relationships and operational savings. The Council maintains a category of 'social property' which is let to third parties to support social or economic outcomes for communities.

### Specific reviews

- 53 I have also carried out three specific pieces of work during 2008/09 that informed my Use of Resources assessment for the year. The key messages from two of these reviews were reported in the 2007/08 Annual Audit and Inspection Letter in March 2009. These were a review of the implementation of the 'Strategic Services Partnership' (SSP) and 'Housing Management'. I have not therefore repeated these findings within this letter. I have however set out the key findings from the third specific area that I reviewed in the following paragraphs.

### Review of Southampton Health and Well-being Community planning

- 54 I considered how Southampton City Council, Southampton City Primary Care Trust and Southampton University Hospitals NHS Trust (the three partners) are working in partnership to plan and commission services to improve the health and well being outcomes for local people.
- 55 In particular, we were looking at how the local understanding of health needs is used to commission services and how proposed improvements are supported by associated business and resourcing plans. In consultation with chief officers, alcohol harm was selected as a tracer, given that this is a key Local Strategic Partnership priority issue.
- 56 Overall, I concluded that the partners have clear strategic ambitions to address the problem of alcohol harm, and through the Safe City Partnership, are working to develop a framework to deliver these. However, there is a need to ensure that all partners are appropriately engaged in both the development and delivery of need based improvement priorities, which are supported by fully resourced delivery plans.
- 57 The detailed work focused on arrangements between the three partners for addressing alcohol harm. We did not assess whether the conclusions made also applied to partnership working with other organisations involved with the alcohol harm agenda.
- 58 An agreed action plan has been prepared that is focussed upon improving joint commissioning of services and monitoring arrangements to deliver value for money.

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### VFM conclusion

- 59 I assessed your arrangements to secure economy, efficiency and effectiveness in your use of resources against criteria specified by the Audit Commission. For 2008/09 the Audit Commission specified the use of resources KLOE for the Council as set out in table 1 as the relevant criteria for the VFM conclusion at the Council.
- 60 Where the scored judgement is 2 or above, I conclude that the VFM criteria has been met. Therefore, as the Council scored 3 in all categories I issued an unqualified conclusion stating that, in all significant respects, the Council made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2009.

# Audit fees

61 Table 2 below sets out the comparison of actual to planned audit fees for 2008/09.

**Table 2      Audit fees**

	<b>Actual</b>	<b>Planned</b>	<b>Variance</b>
Financial statements and annual governance statement	£214,300	£214,300	£0
Value for money	£98,800	£98,800	£0
Whole of government accounts	£1,600	£1,600	£0
<b>Total audit fees</b>	<b>£314,700</b>	<b>£314,700</b>	<b>£0</b>
Non-audit work	£20,500	£20,500	£0
<b>Total</b>	<b>£335,200</b>	<b>£335,200</b>	<b>0</b>

62 The audit was completed in line with the fee that was agreed with the Council.

63 In addition we have completed Advice and Assistance work in relation to the 'Highways Futures Project' (£13,000) and the review of the Council's Partnership Protocol (£7,500) within the planned fee for these two pieces of work.

## Formal objection and correspondence with electors

64 The fee for the additional work carried out in relation to the formal objection to the 2007/08 financial statements and correspondence with electors for 2007/08 and 2008/09 has amounted to £24,135 up until 30 October 2009. The final fee will not be available until the further matters that have been brought to my attention in relation to the 2008/09 financial statements have been finalised. My estimate for dealing with the objection was £20,000.

# Closing remarks

- 65 I have discussed and agreed this letter with the Chief Executive, Executive Director of Resources and the Council's Solicitor. I presented this letter at the Audit Committee on 10 December 2009 and the Standards and Governance Committee on 15 December 2009 and I will provide copies to all members.
- 66 Further detailed findings, conclusions and recommendations in the areas covered by our audit are included in the reports issued to the Council during the year.

**Table 3**

Report	Date issued
Audit and Inspection Plan 2008/09	March 2008
Housing Management Performance*	August 2008
Review of SSP Implementation*	November 2008
Use of Resources 2008*	December 2008
Data Quality 2008*	December 2008
Review of Southampton health and well-being community planning	September 2009
Annual Governance Report (incl. UoR and Data Quality for 2009 **)	September 2009
Opinion on the Financial Statements	September 2009
Value for Money Conclusion	September 2009
Decision on objection and statement of reasons	October 2009
Annual Audit Letter	December 2009

## Notes

'\*' Report included in the Annual Audit and Inspection Letter 2007/08, which was issued in March 2009.

'\*\*' Included in the 2009/10 audit fee.

Kate Handy  
District Auditor  
December 2009

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# The Audit Commission

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

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