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Report to those charged with governance (ISA 260) 2013/14

South Holland District Council

September 2014

Contents

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled *Statement of Responsibilities of Auditors and Audited Bodies*. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document which is available on the Audit Commission's website at www.auditcommission.gov.uk.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Neil Bellamy**, the appointed engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit, Audit Commission, 3rd Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 0303 4448 330.**

Introduction

This document summarises:

- **the key issues identified during our audit of the financial statements for the year ended 31 March 2014 for the Authority; and**
- **our assessment of the Authority’s arrangements to secure value for money.**

Scope of this report

This report summarises the key findings arising from:

- our audit work at South Holland District Council (‘the Authority’) in relation to the Authority’s 2013/14 financial statements; and
- the work to support our 2013/14 conclusion on the Authority’s arrangements to secure economy, efficiency and effectiveness in its use of resources (‘VFM conclusion’).

Financial statements

Our *External Audit Plan 2013/14*, presented to you in February 2014, set out the four stages of our financial statements audit process.

This report focuses on the second and third stages of the process: control evaluation and substantive procedures. Our on site work for these took place during April 2014 (interim audit) and August 2014 (year end audit).

We are now in the final phase of the audit, the completion stage. Some aspects of this stage are also discharged through this report.

VFM conclusion

Our *External Audit Plan 2013/14* explained our risk-based approach to VFM work, which follows guidance provided by the Audit Commission. We have now completed our work to support our 2013/14 VFM conclusion. This included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion; and
- considering the results of any relevant work by the Authority and other inspectorates and review agencies in relation to these risk areas.

Structure of this report

This report is structured as follows:

- Section two summarises the headline messages.
- Section three sets out our key findings from our audit work in relation to the 2013/14 financial statements of the Authority.
- Section four outlines our key findings from our work on the VFM conclusion.

Our recommendations are included at Appendix 1.

Acknowledgements

We would like to take this opportunity to thank officers and Members for their continuing help and co-operation throughout our audit work.

Headlines

This table summarises the headline messages. Sections three and four of this report provide further details on each area.

Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2014. We will also report that the wording of your Annual Governance Statement accords with our understanding.
Audit adjustments	We are pleased to report that our audit of your financial statements did not identify any material adjustments. The Authority made a small number of non-trivial adjustments, most of which were of a presentational nature. There was no impact on the General Fund. We have raised one recommendation arising from our work, which is set out in Appendix 1.
Key financial statements and other audit risks	We review risks to the financial statements on an ongoing basis. We have worked with Officers throughout the year to discuss the specific risk areas for this year's audit. The Authority addressed the issues appropriately.
Accounts production and audit process	The Authority has good processes in place for the production of the accounts and excellent quality supporting working papers. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales.
Control environment	The Authority's organisational control environment is effective overall, and we have not identified any significant weaknesses in controls over key financial systems.
Completion	At the date of this report our audit of the financial statements is complete. Before we can issue our opinion we require a signed management representation letter. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.
VFM conclusion and risk areas	We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2014.

Proposed opinion and audit differences

We have identified no issues in the course of the audit that are considered to be material.

We anticipate issuing an unqualified audit opinion in relation to the Authority's financial statements by 30 September 2014.

The wording of your Annual Governance Statement accords with our understanding.

Proposed audit opinion

We anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Governance and Audit Committee on 25 September 2014.

Audit differences

In accordance with ISA 260 we are required to report uncorrected audit differences to you. We also report any material misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities.

We did not identify any material misstatements, although we identified a small number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting the United Kingdom 2013/14 ('the Code')*. These have all been addressed by the Authority.

Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

- it complies with *Delivering Good Governance in Local Government: A Framework* published by CIPFA/SOLACE; and
- it is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

Key financial statements risks and other audit issues

We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.

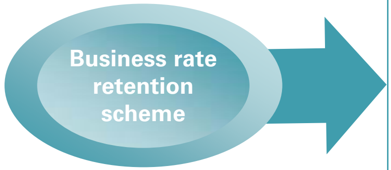
In our External Audit Plan 2013/14, presented to you in February 2014, we identified the key risks and other audit issues affecting the 2013/14 financial statements. Subsequent to this we have also identified an additional risk around the accounting for the business rate retention scheme. We have now completed our testing of these areas and set out our evaluation following our substantive work.

Key financial statements audit risks

The table below sets out our detailed findings for each of the risks that are specific to the Authority.

Key audit risk	Issue	Findings
LGPS Triennial Valuation	During the year, the Local Government Pension Scheme for Lincolnshire (the Pension Fund) has undergone a triennial valuation with an effective date of 31 March 2013 in line with the Local Government Pension Scheme (Administration) Regulations 2008. The Authority's share of pensions assets and liabilities is determined in detail, and a large volume of data is provided to the actuary in order to carry out this triennial valuation. The IAS 19 numbers to be included in the financial statements for 2013/14 will be based on the output of the triennial valuation rolled forward to 31 March 2014. For 2014/15 and 2015/16 the actuary will then roll forward the valuation for accounting purposes based on more limited data. There is a risk that the data provided to the actuary for the valuation exercise is inaccurate and that these inaccuracies affect the actuarial figures in the accounts. Most of the data is provided to the actuary by Lincolnshire County Council who administer the Pension Fund.	As part of our audit we have confirmed: ▪ that the Authority has obtained an independent actuarial valuation; ▪ that the underlying data submitted to the actuary for this purpose was complete and accurate; ▪ that the assumptions underpinning the actuarial valuations have been reviewed by management and found to be reasonable; and ▪ that the IAS19 figures in the accounts agree to the information provided by the actuary.

Key financial statements audit risks and other audit issues (continued)

Key audit risk	Issue	Findings
	With the introduction of Business Rate Localisation, which took effect from 1 April 2013, there were significant changes in the requirements for the disclosure of Non Domestic Rate balances and transactions, as per the CIPFA Code. This meant there were significant variances in the Collection Fund, Balance Sheet and the CIES as a result of the change of accounting treatment. In addition, the requirement ceased for an audited National Non Domestic Rate (NNDR) Return where auditors had completed certification work in this area in line with directions issued by the Audit Commission. These factors meant that we reassessed Non Domestic Rates as a significant audit risk. We are currently in discussion with the Audit Commission about how this additional work is to be funded, and may result in an additional audit fee, but on the other hand there will be no NNDR certification fee.	We have reviewed the Authority's accounting treatment for business rates and confirmed that it is in line with the CIPFA guidance.

Professional standards

Additionally, we considered the risk of management override of controls, which is a standard risk for all organisations.

Our controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual, did not identify any issues.

Other audit issues

The table below sets out the other issue we have identified through our planning work that is specific to the audit of the Authority's financial statements for 2013/14.

Section three

Key financial statements audit risks and other audit issues (continued)

Other audit issues	Issue	Findings
New Fixed Asset Register	During the year, the Council has implemented a new fixed asset register system. There is a risk that the data transferred between the systems is incomplete or inaccurate and that these inaccuracies affect the figures in the accounts.	We have confirmed the completeness and accuracy of the data migration between the two systems, in particular confirming that the previous year's closing asset register balances were in agreement to the current year's opening balances for each respective class of asset.

Accounts production and audit process

The Authority has good processes in place for the production of the accounts and excellent quality supporting working papers.

Officers dealt proactively with audit queries and the audit process could be completed within the planned timescales.

The Authority has implemented both the recommendations in our *ISA 260 Report 2012/13.*

Accounts production and audit process

ISA 260 requires us to communicate to you our views about the significant qualitative aspects of the Authority's accounting practices and financial reporting. We also assessed the Authority's process for preparing the accounts and its support for an efficient audit.

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority has good financial reporting processes in place. We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 24 June 2014.
Quality of supporting working papers	Our *Accounts Audit Protocol*, which we issued in February 2014 and discussed with the Senior Finance Analyst, set out our working paper requirements for the audit. The quality of working papers provided were excellent and assisted the delivery of a smooth audit engagement.
Response to audit queries	Officers were proactive in resolving all audit queries promptly, again assisting in the delivery of a smooth audit engagement.

Element	Commentary
Group audit	To gain assurance over the Authority's group accounts, we placed reliance on work completed by KPMG LLP on the financial statements of Compass Point Business Services (East Coast) Limited, and Bulley Davey on the financial statements of South Holland Local Housing Community Interest Company. There are no specific matters to report pertaining to the group audit.

As part of our audit we have specifically followed up the Authority's progress in addressing the recommendations in last year's ISA 260 report.

The Authority has implemented both the recommendations in our *ISA 260 Report 2012/13*.

Control environment

The Authority's organisational control environment is effective, and controls over the key financial systems are sound.

We have not identified any matters which would indicate that internal audit are not compliant with Public Sector Internal Audit Standards.

During April 2014 we completed our control evaluation work. We did not issue an interim report as there were no significant issues arising from this work. For completeness we reflect on key findings from this work.

Organisational control environment

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would have implications for our audit. We therefore obtain an understanding of the Authority's overall control environment and determine if appropriate controls have been implemented.

We found that your organisational control environment is effective overall.

Review of Internal Audit

We work with your internal auditors to assess the control framework for certain key financial systems and seek to rely on any relevant work they have completed to minimise unnecessary duplication of work.

Where we intend to rely on internal audit's work in respect of the Authority's key financial systems, auditing standards require us to complete an overall assessment of the internal audit function and to evaluate and test aspects of their work.

We reviewed internal audit's reports throughout the year to inform ourselves of any significant risks in relation to our opinion work. However, there have been no specific instances during the course of the year where we have sought to rely specifically on the work of internal audit.

We also reviewed internal audit's self assessment against the United Kingdom Public Sector Internal Audit Standards (PSIAS), which have applied to local authorities since April 2013.

Based on the self-assessment performed by internal audit, attendance at the Governance and Audit Committee, review of internal audit reports and regular meetings during the course of the year, we have not identified any matters which would indicate internal audit are not compliant with the PSIAS.

The PSIAS require public sector organisations to commission an external review of internal audit; our work does not constitute an external review with respect to this requirement.

Controls over key financial systems

Where we have determined that this is the most efficient audit approach to take, we test selected controls that address key risks within the financial systems. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

Based on the work of your internal auditors, and our own work on controls over the year end process, the controls over the financial systems are sound.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.

Before we can issue our opinion we require a signed management representation letter.

Once we have finalised our opinions and conclusions we will prepare our *Annual Audit Letter* and close our audit.

Declaration of independence and objectivity

As part of the finalisation process we are required to provide you with representations concerning our independence.

In relation to the audit of the financial statements of South Holland District Council for the year ending 31 March 2014, we confirm that there were no relationships between KPMG LLP and South Holland District Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 2 in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Assistant Director of Finance for presentation to the Governance and Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

ISA 260 requires us to communicate to you by exception 'audit matters of governance interest that arise from the audit of the financial statements' which include:

- significant difficulties encountered during the audit;
- significant matters arising from the audit that were discussed, or subject to correspondence with management;
- other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process; and
- matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. significant deficiencies in internal control; issues relating to fraud, compliance with laws and regulations, subsequent events, non disclosure, related party, public interest reporting, questions/objections, opening balances etc).

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority's 2013/14 financial statements.

VFM conclusion

Our VFM conclusion considers how the Authority secures financial resilience and challenges how it secures economy, efficiency and effectiveness.

We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Background

Auditors are required to give their statutory VFM conclusion based on two criteria specified by the Audit Commission. These consider whether the Authority has proper arrangements in place for:

- securing financial resilience: looking at the Authority's financial governance, financial planning and financial control processes; and
- challenging how it secures economy, efficiency and effectiveness: looking at how the Authority is prioritising resources and improving efficiency and productivity.

We follow a risk based approach to target audit effort on the areas of greatest audit risk. We consider the arrangements put in place by the Authority to mitigate these risks and plan our work accordingly.

The key elements of the VFM audit approach are summarised in the diagram below.

Work completed

We performed a risk assessment earlier in the year and have reviewed this throughout the year.

We identified a single specific risk to our VFM arrangements conclusion although concluded we did not need to complete any additional detailed work.

Conclusion

We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

VFM criterion	Met
Securing financial resilience	✓
Securing economy, efficiency and effectiveness	✓

Specific VFM risks

We have identified a single specific VFM risk.

We are satisfied that external or internal scrutiny provides sufficient assurance that the current arrangements in relation to these risk areas at the Authority are adequate.

Work completed

In line with the risk-based approach set out on the previous page, and in our *External Audit Plan* we have:

- assessed the key business risks affecting the Authority which are relevant to our VFM arrangements conclusion; and
- identified any specific audit risks for our VFM arrangements conclusion, taking account of work undertaken in previous years or as part of our financial statements audit.

Key findings

Below we set out the findings in respect of those areas where we identified an audit risk for our VFM arrangements conclusion.

We concluded that we did not need to carry out additional work for this risk as there was sufficient relevant work that had completed by the Authority, inspectorates and review agencies in relation to these risk areas.

Key VFM risk	Risk description and link to VFM arrangements conclusion	Assessment
Delivery of planned budget and savings	As at January 2014, the Authority is forecasting that it will deliver its 2013/14 budget in overall terms. A balanced budget has been set for 2014/15 with budget managers having to closely review these in order to balance individual budgets for the year. However, significant reductions in expenditure or increases in income will be required from 2015-16 onwards, to take account of the reductions in Government funding. Against a backdrop of continued demand pressures for services it will become more and more difficult to deliver these savings in a way that secures longer term financial and operational sustainability. This is relevant to both the financial resilience and economy, efficiency and effectiveness criteria of the VFM conclusion.	No issues have been identified from our review of the specific risk indicators which would suggest that there is a significant adverse impact on financial resilience or value for money. All Local Government bodies have been affected by reductions in central funding and these will continue for the next few years. The Authority has to date responded well to these pressures, demonstrating good performance in identifying and delivering savings whilst maintaining the level of reserves. **Specific risk based work required: No**

Appendix 1: Key issues and recommendations

We have given each recommendation a risk rating and agreed what action management will need to take.

We will formally follow up this recommendation next year.

Priority rating for recommendations		
❶ *Priority one*: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	❷ *Priority two*: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	❸ *Priority three*: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
1	❷	**Componentisation of property, plant and equipment** The Council has failed to componentise four property, plant and equipment assets meeting its policy for componentisation: ▪ Castle Sports Complex Dry Side; ▪ South Holland Centre; ▪ Castle Sports Complex Wet Side; and ▪ Priory Road Offices. As these assets have been revalued at 31 March 2014 there is no financial impact arising in respect of this in the current financial period, although componentisation will ensure that depreciation in future periods is correctly calculated in accordance with the Authority's accounting policy. **Recommendation** The Council should ensure that all assets meeting its componentisation policy are dealt with appropriately.	**Management response** The Council will review its componentisation policy in light of the recommendation to ensure that it accounts for these assets in an appropriate manner in 2014/15. **Responsible officer** Mark Finch (Shared Finance Manager) **Due date** 31 December 2014

Appendix 2: Declaration of independence and objectivity

The *Code of Audit Practice* requires us to exercise our professional judgement and act independently of both the Commission and the Authority.

Requirements

Auditors appointed by the Audit Commission must comply with the *Code of Audit Practice* (the 'Code') which states that:

"Auditors and their staff should exercise their professional judgement and act independently of both the Commission and the audited body. Auditors, or any firm with which an auditor is associated, should not carry out work for an audited body that does not relate directly to the discharge of auditors' functions, if it would impair the auditors' independence or might give rise to a reasonable perception that their independence could be impaired."

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Audit Commission's *Standing Guidance for Local Government Auditors* ('Audit Commission Guidance') and the requirements of APB Ethical Standard 1 *Integrity, Objectivity and Independence* ('Ethical Standards').

The Code states that, in carrying out their audit of the financial statements, auditors should comply with auditing standards currently in force, and as may be amended from time to time. Audit Commission Guidance requires appointed auditors to follow the provisions of ISA (UK &I) 260 Communication of *Audit Matters with Those Charged with Governance*' that are applicable to the audit of listed companies. This means that the appointed auditor must disclose in writing:

- Details of all relationships between the auditor and the client, its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the client, its directors and senior management and its affiliates, that the auditor considers may reasonably be thought to bear on the auditor's objectivity and independence.
- The related safeguards that are in place.
- The total amount of fees that the auditor and the auditor's network firms have charged to the client and its affiliates for the provision of services during the reporting period, analysed into appropriate categories, for example, statutory audit services, further audit services, tax advisory services and other non-audit services. For each category, the amounts of any future services which have been contracted or where a written proposal has been submitted are separately disclosed. We do this in our *Annual Audit Letter*.

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from this. These matters should be discussed with the Governance and Audit Committee.

Ethical Standards require us to communicate to those charged with governance in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on our independence and the objectivity of the Engagement Lead and the audit team.

Appendix 2: Declaration of independence and objectivity (continued)

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.

General procedures to safeguard independence and objectivity

KPMG's reputation is built, in great part, upon the conduct of our professionals and their ability to deliver objective and independent advice and opinions. That integrity and objectivity underpins the work that KPMG performs and is important to the regulatory environments in which we operate. All partners and staff have an obligation to maintain the relevant level of required independence and to identify and evaluate circumstances and relationships that may impair that independence.

Acting as an auditor places specific obligations on the firm, partners and staff in order to demonstrate the firm's required independence. KPMG's policies and procedures regarding independence matters are detailed in the *Ethics and Independence Manual* ('the Manual'). The Manual sets out the overriding principles and summarises the policies and regulations which all partners and staff must adhere to in the area of professional conduct and in dealings with clients and others.

KPMG is committed to ensuring that all partners and staff are aware of these principles. To facilitate this, a hard copy of the Manual is provided to everyone annually. The Manual is divided into two parts. Part 1 sets out KPMG's ethics and independence policies which partners and staff must observe both in relation to their personal dealings and in relation to the professional services they provide. Part 2 of the Manual summarises the key risk management policies which partners and staff are required to follow when providing such services.

All partners and staff must understand the personal responsibilities they have towards complying with the policies outlined in the Manual and follow them at all times. To acknowledge understanding of and adherence to the policies set out in the Manual, all partners and staff are required to submit an annual ethics and independence confirmation. Failure to follow these policies can result in disciplinary action.

Auditor declaration

In relation to the audit of the financial statements of South Holland District Council for the financial year ending 31 March 2014, we confirm that there were no relationships between KPMG LLP and South Holland District Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

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