KPMG

External Audit Report 2015/16

Exeter City Council

20 September 2016

Contents

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Section one: Introduction

Introduction

This document summarises:

- **The key issues identified during our audit of the financial statements for the year ended 31 March 2016 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 Exeter City Council ('the Authority') in relation to the Authority's 2015/16 financial statements; and
- The work to support our 2015/16 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 2015/16*, presented to you in February 2016, set out the four stages of our financial statements audit process.

This report focuses on the third stage of the process: substantive procedures. Our on site work for this took place during July to September 2016.

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 2015/16 explained our risk-based approach to VFM work. We have now completed the work to support our 2015/16 VFM conclusion. This included:

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

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our audit work in relation to the 2015/16 financial statements of the Authority and the fund.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1.

Acknowledgements

Following appointment, this was our first year as your external auditors of Exeter City Council. We would like to take this opportunity to thank officers and Members for their continuing help and co-operation throughout our audit work.

Section two: Headlines

Headlines

This table summarises the headline messages for the Authority. 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 2016. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.
Audit adjustments	Our audit has not identified any significant misstatements as documented in Appendix one to this report. 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 2015/16 ('the Code'). The Authority has addressed these where significant.
Key financial statements audit risks	We identified the following key financial statements audit risks in our 15/16 External audit plan issued in February 2016: – Valuation of Property, Plant & Equipment - As revaluations occur up to every five years, the time delay could result in a material difference between the carrying value and fair value. We tested the revaluation entries of both the HRA and Non-HRA assets and we are satisfied that the valuation approach in place at the Authority does not lead to a material difference between the carrying value and fair value. – Management override of controls - This risk is present in all entities as management is in a unique position to manipulate accounting records. The audit approach will test the appropriateness of journal entries recorded in the general ledger, review the appropriateness of accounting estimates, and assess the reasonableness of provisions. We tested the operating effectiveness of the Executive's Quarterly review of the Authority's results. In addition we tested the journal entries recorded in the general ledger, focused on the areas we considered to be at high risk of manipulation. During our testing on journals, we have raised a recommendation within Appendix one relating to a weakness in controls surrounding segregation of duties. We have worked with officers throughout the year to discuss these key risks and our detail findings are reported in section 3 of this report.
Accounts production and audit process	We received complete set of draft accounts by 30 June 2016 in accordance with the Accounts & Audit Regulations deadline. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code. We will debrief with the finance team to share views on the final accounts audit. Hopefully this will lead to further efficiencies in the 2016/17 audit process. In particularly we would like to thank Authority Officers who were available throughout the audit visit to answer our queries.

Headlines (cont.)

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

VFM conclusion and risk areas	Our External audit plan 2015/16 issued in February 2016 did not include our detailed assessment of your VFM risks. We follow a risk based approach to target audit effort on the areas of greatest audit risk. During the audit we have considered the following as VFM risks: — Impact of the performance of Strata Service Solutions on the Authority; — Non-compliance with the procurement process; and — New development of the leisure centre and bus station. We have worked with officers throughout the year to discuss these risks and our detailed findings are reported in section 4 of this report. We anticipate issuing a qualified VFM conclusion, as a result of significant weaknesses in the procurement process. From investigation, the Authority has a significant number of supplier payments being made where contracts cannot be found and as already highlighted by your internal auditors a number of cases where the Authority has not followed the correct procurement process. Our conclusion will include an “except for” paragraph stating that we are satisfied with the Authority's arrangements except for the issue detailed above.
Completion	At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas: — Review of contracts in place in respect of the VFM risk identified; — Completing audit work on a number of disclosures, e.g. cash flow statement, Movement in reserves; — Review of the Authority’s Whole of Government Accounts pack; and — Final completion work over the financial statements. You are required to provide us with representations on specific matters such as your going concern assertion and whether the transactions in the accounts are legal and unaffected by fraud. We provided a draft of this representation letter to the Section 151 Officer on 14 September 2016. We draw your attention to the requirement in our representation letter for you to confirm to us that you have disclosed all relevant related parties to us. 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.

Section three: Financial Statements

Proposed opinion and audit differences

We have not identified any audit adjustments 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 the deadline of 30 September 2016.

The wording of your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Audit Committee on 28 September 2016.

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.

The final materiality (see Appendix two for more information on materiality) level for this year's audit was set at £1.6 million. Audit differences below £80,000 are not considered significant.

We did not identify any material misstatements. We identified a number of presentational changes required to ensure that the accounts are compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 ('the Code'). We understand that the Authority will be addressing these where significant.

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.

We had a number of amendments on the Annual Governance Statement which have been addressed by management.

Narrative report

We have reviewed the Authority's narrative report and can confirm it is consistent with our understanding of the Authority. We have suggested that in future years the Authority should consider incorporating additional non-financial performance information.

Significant audit risks

We have worked with the Authority throughout the year to discuss significant risks and key areas of audit focus.

This section sets out our detailed findings on those risks.

In our *External Audit Plan 2015/16*, presented to you in February 2016, we identified the significant risk affecting the Authority's 2015/16 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

The table below sets out our detailed findings for the risk that is specific to the Authority.

Significant Risk: Valuation of Property, Plant & Equipment (PPE)

— Risk

Authorities are responsible for ensuring the valuation of their PPE is materially correct, and for conducting impairment reviews that confirm the condition of these assets. Local authorities typically achieve this by performing an annual review for impairment, a periodic desk top valuation (every three years) and a full valuation in not more than five yearly intervals. The asset valuation and impairment review processes are both estimates and therefore present a higher level of risk to the audit.

— Findings

We obtained and reviewed the terms of engagement with the valuer to ensure compliance with the Authority's accounting policies.

We reviewed the instructions provided to the valuer and considered the source of the information and undertook appropriate testing to ensure both its completeness and accuracy.

We challenged the appropriateness of any amendments made by management to the information received from the valuer before being incorporated into the financial statements.

We undertook appropriate work to understand the basis upon which any impairments to land and buildings have been calculated and reviewed the associated assumptions to determine if there have been any significant variances in fair value between valuations.

We performed testing of a sample of revaluations and discussed with management any changes in use / surplus properties and how this has been considered in the valuations.

There are no matters arising from this work that we need to bring to your attention.

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Significant audit risks (Cont'd)

We have worked with the Authority throughout the year to discuss significant risks and key areas of audit focus.

This section sets out our detailed findings on those risks.

In our *External Audit Plan 2015/16* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. These risk areas were Management override of controls and the Fraud risk of revenue recognition.

The table below sets out the outcome of our audit procedures and assessment on these risk areas.

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Fraud risk of revenue recognition

Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.

In our External Audit Plan 2015/16 we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue.

This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.

Management override of controls

Professional standards require us to communicate the fraud risk from management override of controls as significant because management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

Our audit methodology incorporates the risk of management override as a default significant risk. We have not identified any specific additional risks of management override relating to this audit.

In line with our methodology, we carried out appropriate 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.

From our testing, we have raised a recommendation within Appendix one relating to a weakness in controls surrounding segregation of duties of journals.

Other areas of focus

In our External Audit Plan 2015/16, presented to you in February 2016, we identified one other area of audit focus.

This is not considered a significant risk but areas of importance where we would carry out some substantive audit procedures to ensure there is no risk of material misstatement.

Area of focus: Strata Service Solutions Limited (STRATA)

— Area

STRATA is a shared ICT service, which was set up in 2014 by three local authorities; East Devon District Council, Exeter City Council and Teignbridge District Council.

The Authority holds an equal shareholding in Strata with two other local authorities. When Strata began trading, staff transferred over from the three local authorities under TUPE arrangements. Strata took over the full pensions liabilities relating to these staff, which in some cases had been built up over decades of authority service.

The Authority treated this transaction as a joint operation within its 2014/15 financial statements. However, when the Authority consolidated the figures for Strata it did not account for the built up pension liabilities that had accrued which amounted to £1.136m (total strata liability). Your previous external auditors highlighted this to you in their ISA 260 report for 2014/15.

This year we understand from management that the figures involved for the accrued pension liabilities will be material to your financial statements. The Authority has been consulting with its lawyers and drafted a 'Deed of Guarantee' which makes it clearer that Strata has no past service liability for the pension deficit and it will be covered by the three authorities but Strata has responsibility for any in year amounts going forward.

— Findings

KPMG reviewed the arrangement in place with STRATA which involved: reviewing the agreement in place with the three authorities, holding discussing with management on the structure and governance arrangements in place.

Management have treated STRATA as a joint operation in their financial statements. From our testing we found that the treatment as a joint operation is appropriate and assessed this against the Code of Practice on Local Authority Accounting for 2015/16. This means that the Authority's share of STRATA's assets, liabilities and profit have been brought into each shareholder's Balance Sheet and Comprehensive Income and Expenditure Statement.

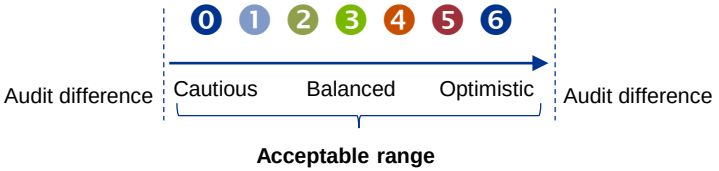
It was found that the 'Deed of Guarantee' had been drafted, but has not been signed by the Authority as consultation of the Deed is on-going with the lawyers.

We have ensured the consolidation is correct, with no issues noted.

Judgements

We always consider the level of prudence within key judgements in your financial statements. We have summarised our view below using the following range of judgement:

Level of prudence

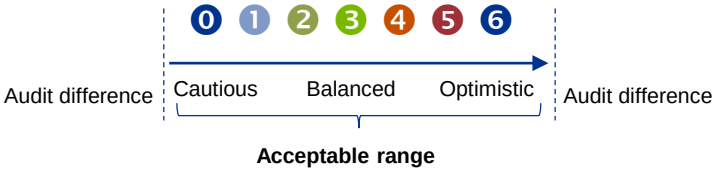


Assessment of subjective areas			
Asset/liability class	**2015/16**	**Balance (£m)**	**KPMG comment**
Property, Plant and Equipment (valuations)	3	**£347 million**	As noted on page 10, the Authority has a revaluation program in place for it's HRA and Non-HRA assets. The HRA assets are valued by an internal in house valuer who values Council Dwellings at Existing Use Value for Social Housing which is required by HM Treasury and by CIPFA for Local Authorities. All non-Council Dwellings are revalued by an in-house valuer. The non-HRA assets are valued at existing use or Deprecated replacement cost, where there is no active market, fair value is used for industrial estates and historical cost for infrastructure assets. It was found that the assumptions made by the internal valuers were appropriate.
Pensions	4	**£89.4 million**	The amount relates to the Local Government Pension Scheme. The scheme at the entity is currently in liability with the present value of the defined benefit obligations being (£193.4 million) and the fair value of the plan assets being £104 million. The Authority engages Barnett Waddingham as their actuary. KPMG have reviewed the assumptions made by the actuary and compared these to assumption's developed by our actuaries. It was found that the assumptions used by Barnett Waddingham are within the tolerable ranges set by our actuaries, it was noted however that for each assumption made by the Authority's actuary that this was towards the optimistic side of the threshold.

Judgements (Cont'd)

We always consider the level of prudence within key judgements in your financial statements. We have summarised our view below using the following range of judgement:

Level of prudence



Assessment of subjective areas			
Asset/liability class	**2015/16**	**Balance (£m)**	**KPMG comment**
Sundry creditors (accruals)	3	**£8.8 million**	Accruals consists of a significant amount of low value transactions. A sample was taken and agreed back to supporting documentation. No issues were noted.
Debtors provisioning / business rate appeals	3	**£3.4 million**	The amount relates to the provision for Non-Domestic Rates that will not be recoverable due to claims or reductions on rate amounts. The client totals the amount of claims outstanding as at 31 March 2016 and applies a success percentage to the amount to determine the total provision. This amount is then allocated to the Precepts, the Authority taking 40% of the provision in line with the Precept value. KPMG agree these amounts with no issues noted.

Accounts production and audit process

The draft accounts and supporting working papers presented to us for audit were to a good standard.

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

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	This is the first year audit of the Authority and we noted that the financial reporting process at the Authority is appropriate.
Completeness of draft accounts	A complete set of draft accounts were provided to us on 30 June 2016 and were a complete set for us to be able to commence our audit procedures. The Authority has made a small number of presentational changes to the accounts presented for audit however there have been no changes which we consider to be fundamental.
Quality of supporting working papers	Our *Accounts Audit Protocol*, which we issued on 28 January 2016 and discussed with your Technical Accounting Manager, sets out our working paper requirements for the audit. The quality of working papers provided was to a good standard as specified in our *Accounts Audit Protocol*.
Response to audit queries	Officers resolved all audit queries in a timely manner.

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 Exeter City Council for the year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and Exeter City 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 Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix three 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 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.

Section four: Value for Money

VFM Conclusion

Our VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We follow a risk based approach to target audit effort on the areas of greatest audit risk.

We have concluded that the Authority has made proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned sustainable outcomes for taxpayers and local people except for its arrangements for procuring supplies and services effectively with partners and third parties.

Background

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to cause the auditor to reach an inappropriate conclusion on the audited body's arrangements.'

The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria.

These sub-criteria provide a focus to our VFM work at the Authority.

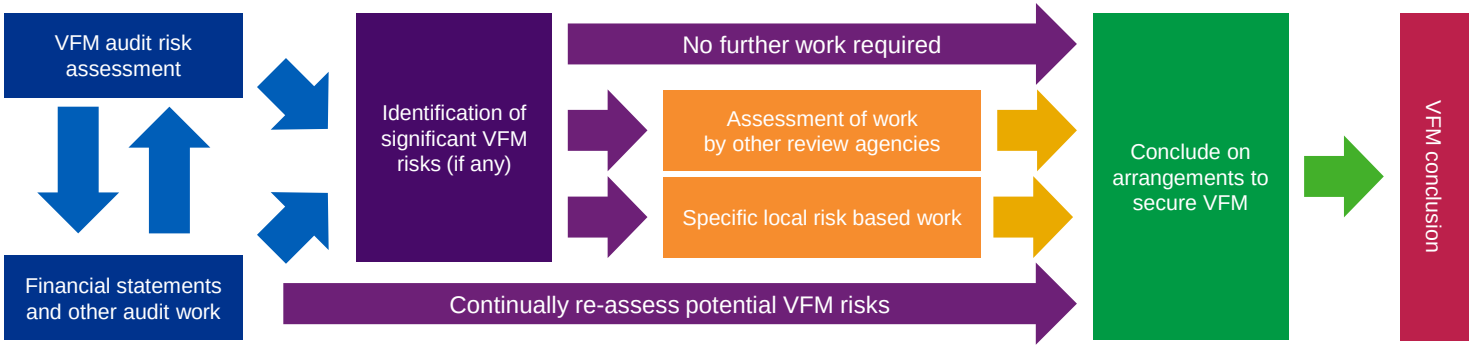
Conclusion

We have concluded that the Authority has not made proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Overall criterion

In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Informed decision making	Sustainable resource deployment	Working with partners and third parties
✓	✓	X
Met	**Met**	**Not Met**



Specific VFM Risks

We have identified a number of specific VFM risks.

We are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas 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 Authority's key business risks which are relevant to our VFM conclusion;

— Identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;

— Considered the results of relevant work by the Authority, inspectorates and review agencies relating to these risk areas;

— Completed specific local risk based work.

Key findings

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

We concluded that we needed to carry out additional work for some of these risks. This work is now complete and we also report on this below.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Impact of the performance of Strata Service Solutions on the Authority.	The implementation of STRATA was considered a VFM risk as the objective of the company is for cost savings to be made through the sharing of ICT across Exeter City Council, East Devon District Council, and Teignbridge Council. This is relevant to, sustainable resource deployment and working with partners and third parties sub-criteria of the VFM conclusion.	The three partner authorities have agreed terms for joint executive and scrutiny committees to enable and scrutinise the joint management of STRATA and to ensure that the initiative is meeting it's cost saving objective. **Specific risk based work required: Yes** In addition to reviewing the joint executive committee meeting minutes, KPMG gained an understanding of the cost monitoring process, reviewed the business plan and most recent financial statements to determine if the implementation was achieving the cost saving that were intended. Our testing provides comfort that the Authority has appropriate arrangements to manage and monitor the services it receives from STRATA and the costs and savings associated with it.

Specific VFM Risks (cont.)

We have identified a number of specific VFM risks.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Non-compliance with procurement process	Recent internal audit reports have identified issues relating to procurement and contracting arrangements, particularly in relation to housing spend. The Authority has also identified and recognised procurement as a significant governance risk within the Annual Governance Statement. There is a risk the Authority is not achieving value for money in its contracts or breaching procurement legislation due to possible failures to follow procurement policy or issues within the Authority's procurement policy itself. This is relevant to the criteria of working with partners and third parties sub criteria of the VFM conclusion.	Our work performed consisted of: **Review of reports** The internal audit review identified issues relating to non compliance with the Authority's own procurement policy. Following this, a procurement consultant was commissioned by the Authority during the year to establish an action plan, implement a sound procurement process and to gather a list of all supplier payments that had contracts in place. **Review of action plan** The procurement consultant drew up an assessment of the current process and an action plan in response to issues identified. The following actions were agreed: • Consideration of the expected costs of contracting the services of an external supplier or performing the service in –house. • Develop an official supplier list. • Set up of an independent programme board. • Develop a new procurement strategy. • Update the Contract and Procurement Procedure Rules and Financial regulations. • Develop an effective training plan. The procurement consultant has drawn up a listing of supplier payments which shows that there were over 97 suppliers (over a £50k threshold) amounting to £24.9m of Authority spend. Officers analysis of the £24.9m spend indicates that £19.7m (79%) can be supported with contracts, which leaves £3.6m (21%) where contracts cannot be found and £1.6m where contracts were not required. (Cont.)

Specific VFM Risks (cont.)

We have identified a number of specific VFM risks.

Key VFM risk	Assessment
Non-compliance with procurement process	(Cont.) The Authority has spent a significant amount of resource in identifying a supplier listing, identifying whether the contracts are in place, terms of the contracts and whether the correct procurement process has been taken. The Authority is still working through this exercise. **Sample testing** As a result of the residual issues above, we decided sample testing was necessary to ensure that the Authority's contract list was accurate. This consisted of selecting a sample of contracts from the Authority's contract list to ensure that supplier payments were supported by contracts and were in line with the procurement policy. The Authorities own a Within this testing, we identified a number of issues: • We identified instances where the Authority had not followed the correct quotation and tendering process or demonstrated it had been followed e.g works and service contracts £529k, £277k, £99k, £38k; • We found examples where appropriate procurement process was followed but it was poorly evidenced and in some cases the documentation was not retained; • Examples where supplier payments had no supporting contracts in place, e.g £277k, £114k; • Examples where the contract was in place but it had expired and evidence was not produced for an extension e.g service contract £148k. This is in addition to the £3.6m of contracts where the Authority's own analysis indicates that spend is unsupported by contracts and appropriate procurement processes. (Cont.)

Specific VFM Risks (cont.)

We have identified a number of specific VFM risks.

Key VFM risk	Assessment
Non-compliance with procurement process	We have discussed these issues with relevant officers across the Authority and note that the issues have been identified by the Authority and steps being put in place to address these with the implementation of the action plan as well as a more centralised procurement overview. However, based on the extent of non-compliance in relation to 2015/16, and the fact that the action plan was not yet implemented during the 2015/16 audit year, we have concluded that it is appropriate to quality our VFM conclusion on an “except for“ basis. This means that we have concluded that the Authority has proper arrangements to secure value for money, except for its arrangements for procuring supplies and services effectively to support the delivery of strategic priorities.

Specific VFM Risks (cont.)

We have identified a number of specific VFM risks.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
New development of the leisure centre and bus station	The Authority has proposed a redevelopment of the existing bus station in Exeter to provide for a leisure complex and a new bus station. This is relevant to, sustainable resource deployment and working with partners and third parties sub-criteria of the VFM conclusion.	KPMG obtained an update as to the proceedings on the redevelopment of the bus station and the new development of a leisure centre. **Specific risk based work required: Yes** Through discussions held with the Authority and inspection of contracts and cash flow projections, the new development is currently in the advanced planning phase. Our testing provides comfort that the Authority has appropriate arrangements to manage and monitor the new development complex.

Appendices

Appendix one

Key issues and recommendations

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

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

Priority rating for recommendations					
1	***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.	2	***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.	3	***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	1	**Authorisation of journal entries** At present the Authority has a list of authorised users who are able to post and authorise journals. There is no segregation of duties and the same individual can post and authorise their own journals. There is no sample checking or reports that are used to spot check authorised journals to ensure that they are legitimate. In addition, your Assistant Director of Finance is able to post journals to the general ledger which raises the risk of management override of controls. During our sample testing we did not identify any instance where your Assistant Director of Finance posted journals. **Recommendation** The finance system should be updated with software to enable the functionality to allow separate posting and authorisation of journals. If this is not possible due to system limitations, spot checks should be performed by someone independent to the person posting, on a monthly basis to ensure journals are supported and legitimate.	**Management response** Agreed. The Technical Accounting Manager has been working with Internal Audit in order to introduce a new system for journal authorisation. A new system has been trialled since 1st July 2016 whereby separate officers post and authorise journals, however the financial system does not have the functionality to enforce the separation of posting and authorisation of journals, it is therefore reliant on officers to adhere to. A review of the trial period is due to be undertaken in conjunction with Internal Audit as part of the Main Accounting Audit in order to determine the optimum long term solution, so that it may also be agreed with our external auditors. In addition, the system access rights of the Assistant Director Finance have been updated which have removed their ability to post and authorise journals. **Responsible officer** Assistant Director of Finance **Due date** 1 December 2016

Key issues and recommendations (Cont.)

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

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
2	1	**Super user access and segregation of duties over the payroll function** Members of the Payroll department are able to add/delete employees, process and review the payroll and BACS payments. All staff within this department have super user access to the HR and payroll systems. As a result there is a lack of segregation of duties. **Recommendation** Appropriate segregation of duties should be in place and there should be an additional layer who reviews the payroll report and particularly the exception report prior to payroll being sent for processing.	**Management response** Agreed. On a short-term basis the Transactional Services Manager will review the exception report prior to payroll is finalised. However, in the absence of the Transactional Services Manager, the Transactional Services Team Leader will need to undertake this duty. In order ensure effective segregation of duties are maintained, the Corporate Manager Legal & HR will review the Payroll function and assess whether additional resources are required. **Responsible officer** Corporate Manager Legal & HR. **Due date** 31 March 2017

Key issues and recommendations (Cont.)

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

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
3	1	**Procurement process** The procurement process appears to be weak and has led to non-compliance with regulations and internal policy. This was highlighted to you by your internal auditors in November 2015. Since the internal audit review, the Authority has been working on obtaining a complete and accurate listing of supplier payments to ensure that contracts are in place and that terms and conditions are being adhered to. The Authority is also investigating to ensure that the correct procurement process had been performed. At the time of this report, this work was still ongoing. This exposes the Authority to a risk of failing to achieve value for money for tax payers and a risk of challenge from unsuccessful contractors. As a result, the Authority recruited a procurement consultant to perform a review of the process which raised a number of issues, and is currently in the process of implementing an action plan. Given the critical importance of procurement it is vital that the Authority delivers the changes required to strengthen its arrangements and ensure compliance with these enhanced policies and procedures. The action plan therefore represents a vital process and it is important that it is sufficiently resourced, closely monitored and delivered on a timely basis. **Recommendation** Ensure progress in delivering the procurement action plan is closely monitored and that sufficient resource is available to implement the required improvements to the Council's procurement arrangements.	**Management response** Agreed. A report is being prepared for the 11 October Executive to begin the process of delivering the new Procurement function. It is anticipated that the team will be in place by April 2017. **Responsible officer** Assistant Director of Finance **Due date** April 2017

Appendix two

Audit differences

This appendix sets out the significant audit differences identified during the audit for the year ended 31 March 2016.

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which in your case is the Audit Committee). We are also required to report all material misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities.

Corrected audit differences

There were no misstatements identified that required correction in the financial statements.

Uncorrected audit differences

There were no uncorrected audit differences identified.

Materiality and reporting of audit differences

For 2015/16 our materiality is £1.6 million for the Authority's accounts.

We have reported all audit differences over £0.8 million for the Authority's accounts

Materiality

The assessment of what is material is a matter of professional judgment and includes consideration of three aspects: materiality by value, nature and context.

— Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.

— Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.

— Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We reassessed materiality for the Authority at the start of the final accounts audit. The reassessment of materiality was based on the control testing performed and using our professional judgement, materiality was increased from £1.2 million (as documented in the external audit plan issued in February 2016) to £1.6 million.

Materiality for the Authority's accounts was set at £1.6 million which equates to around 1.6 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any misstatements of lesser amounts to the extent that these are identified by our audit work.

Under ISA 260, we are obliged to report omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

ISA 450 requires us to request that uncorrected misstatements are corrected.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £0.8 million for the Authority.

Where management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit Committee to assist it in fulfilling its governance responsibilities.

Declaration of independence and objectivity

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice.

Requirements

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice (the 'Code') which states that:

"The auditor should carry out their work with integrity, objectivity and independence, and in accordance with the ethical framework applicable to auditors, including the ethical standards for auditors set by the Financial Reporting Council, and any additional requirements set out by the auditor's recognised supervisory body, or any other body charged with oversight of the auditor's independence. The auditor should be, and should be seen to be, impartial and independent. Accordingly, the auditor should not carry out any other work for an audited body if that work would impair their independence in carrying out any of their statutory duties, or might reasonably be perceived as doing so."

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 Public Sector Audit Appointments Ltd *Terms of Appointment* ('Public Sector Audit Appointments Ltd 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. Public Sector Audit Appointments Ltd guidance requires appointed auditors to follow the provisions of ISA (UK&I) 260 Communication of A*udit 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 his. These matters should be discussed with the 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.

Declaration of independence and objectivity (Cont.)

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 Exeter City Council for the financial year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and Exeter City 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 Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Appendix three

Audit Independence

Audit Fees

Our scale fee for the audit was £57,887 (excluding VAT) in 2015/16. This fee was in line with that highlighted within our audit plan agreed by the Audit Committee in February 2016.

Non-audit services

We have been appointed to certify your Housing Revenue Account Pooling Return for 2015/16. We shall set out details of fees for this work in our Annual Audit Letter later this year.

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