KPMG

External audit report 2016/17

Exeter City Council

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September 2017

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Summary for the Audit Committee

Financial statements

This document summarises the key findings in relation to our 2016-17 external audit at Exeter City Council ('the Authority).

This report focusses on our on-site work which was completed in February 2017 and July 2017 on the Authority's significant risk areas, as well as other areas of your financial statements. Our interim audit findings are presented on pages 3-7,with the final audit work on pages 8-19.

Subject to all outstanding queries being resolved to our satisfaction we anticipate issuing an unqualified audit opinion on the Authority's financial statements on 20 September 2017 (which is nearly two weeks before the statutory deadline of 30 September 2017).

We have identified three audit adjustments with a total net value of £327 thousand.

Based on our work, we have raised two recommendations. Details on our recommendations can be found in Appendix One.

We are now in the completion stage of the audit and anticipate issuing our completion certificate and Annual Audit letter in November 2017.

Value for Money

We have completed our risk-based work to consider whether in all significant respects the Authority has proper arrangements to ensure it has taken properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. 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. This as a result of weaknesses in the procurement process, although we do note that progress has been made since the 2015/16 audit.

We therefore anticipate issuing an 'except for' qualification to our VFM conclusion, as we did last year.

See further details on pages 16-22.

Control Environment

Your organisational control environment is effective overall.

However, we have not tested the controls relating to procurement, payroll and journals as noted in the design and implementation process the controls were not operating effectively through out the year. As a result we have not relied on these controls in our testing.

We have summarised the outcomes of our controls work on page five and have issued full details of our findings and the resulting recommendations to management.

Acknowledgements

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

We ask the Audit Committee to note this report.

KPMG

Section one

Interim Audit

This section summarises the key findings arising from our work completed in February 2017 as part of our interim testing for the 2016/17 Financial Statements.

This covered:

- testing of certain controls over the Authority's key financial systems; and
- review of relevant internal audit work which we are seeking to rely upon.

Organisational Control Environment

Your organisational control environment is effective overall.

Work performed

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 obtain an understanding of the Authority's overall control environment and determine if appropriate controls have been implemented. We do not complete detailed testing over all of these controls.

Key Findings

We consider that your organisational controls are generally effective overall. Unlikely the previous year we did not chose to test the IT environment, we are aware that the processes with Strata are still an ongoing development at the moment. We obtain an understanding of the Authority's overall control environment and determine if appropriate controls have been implemented. We do not complete detailed testing of these controls.

Aspect	Our Assessment	
	2016/17	2015/16
Organisational controls	3	3
Management's philosophy and operating style	3	3
Culture of honesty and ethical behaviour	3	3
Oversight by those charged with governance	3	3
Risk assessment process	3	3
Communications	3	3
Monitoring of controls	3	3

Key:
- 1 Significant gaps in the control environment.
- 2 Deficiencies in respect of individual controls.
- 3 Generally sound control environment.

Controls over Key Financial Systems

The controls over the key financial systems are generally sound. Internal audit have raised a number of recommendations during the year. We have confirmed that these do not have a significant impact on our audit.

Work performed

We review the outcome of internal audit's work on the financial systems to influence our assessment of the overall control environment, which is a key factor when determining the external audit strategy and our audit risk assessment. Our review of internal audit work does not represent an external review against PSIAS, as required at least every five years.

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

Our assessment of a system will not always be in line with the internal auditor's opinion on that system. This is because we are solely interested in whether our audit risks are mitigated through effective controls, i.e. whether the system is likely to produce materially reliable figures for inclusion in the financial statements.

Key Findings

Based on our work, and the work of your internal auditors, in relation to those controls upon which we will place reliance as part of our audit, the key financial systems are generally sound. However, we were unable to rely on some controls throughout the year. The following ratings are based on the design and implementation of the controls in operation at the Council. The deficiencies include:

- We made an assessment that the signatories for approving payroll starters and leavers could not be clearly identified;
- We noted overall issues within the procurement process, in that purchases do not always follow the route of going through a purchase order; and
- A mitigating control over Journal authorisation has been created, however this only became fully operational from October 2016 therefore we were not able to rely on the process throughout the period.

Aspect	Our Assessment	
	2016/17	2015/16
Payroll costs	2	2
Cash and cash equivalents	3	3
Housing Benefits	3	3
Housing Revenue Account	3	3
Council Tax and NNDR	3	3
Purchases	2	2
Journals	2	2

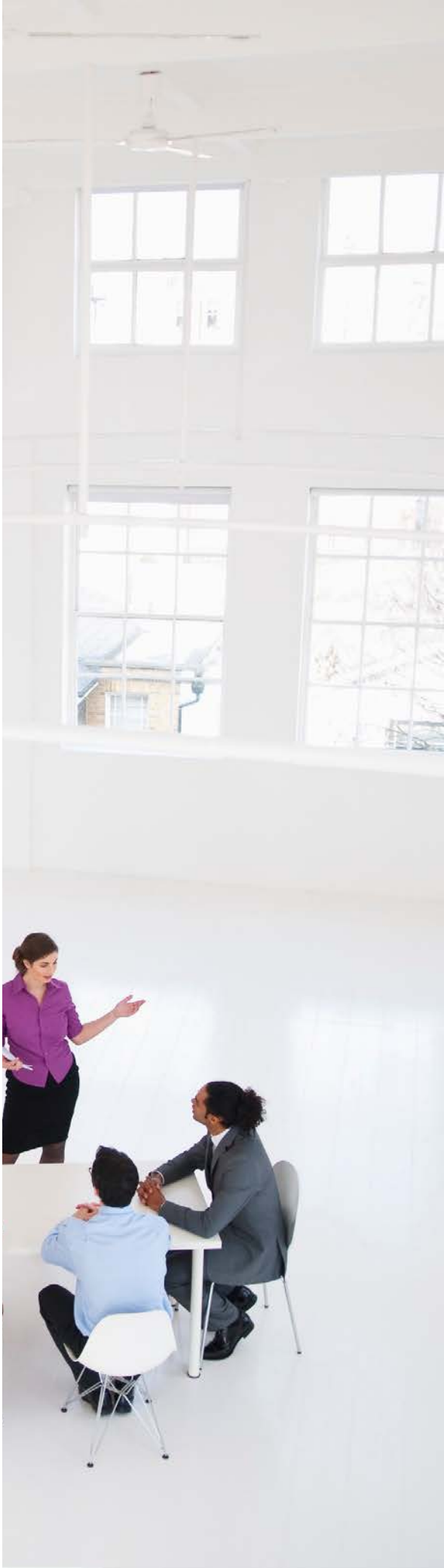
Key:
1. Significant gaps in the control environment.
2. Deficiencies in respect of individual controls.
3. Generally sound control environment.

Section two

Financial Statements

We anticipate issuing an unqualified audit opinion on the Authority's 2016/17 financial statements. We will also report that your Annual Governance Statement complies with the guidance issued by CIPFA/SOLACE (*'Delivering Good Governance in Local Government'*) published in April 2016.

For the year ending 31 March 2017, the Authority has reported a surplus of £13.9 million (post audit). The impact on the General Fund, after statutory accounting adjustments, has been a £0.3 million decrease in the General Fund.



Significant audit risks

Our *External Audit Plan 2016/17* sets out our assessment of the Authority's significant audit risks. We have completed our testing in these areas and set out our evaluation following our work:

Significant audit risks	Work performed
Significant changes in the pension liability due to LGPS Triennial Valuation	**Why is this a risk?** During the year, the Local Government Pension Scheme for Devon County Council(the Pension Fund) has undergone a triennial valuation with an effective date of 31 March 2016 in line with the Local Government Pension Scheme (Administration) Regulations 2013. 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. 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 Devon County Council, which administers the Pension Fund. **Our work to address this risk** We have reviewed the process used to submit payroll data to the Pension Fund and have found no issues. We have also substantively agreed the total figures submitted to the actuary to the general ledger with no issues noted. We critically assessed the assumptions used in the pension valuation at 31 March 2017 to determine whether they were appropriate. No significant issues were noted in respect to the assumptions used. See page 12 for our assessment on the assumptions used by the actuary in the IAS19 report.

Significant audit risks	Work performed
Valuation of Property, Plant & Equipment (PPE)	**Why is this a 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. The net book value of the Authority's PPE as at 31 March 2016 was £347 million of this balance £330 million relates to land and buildings. These balances were estimated by your internal valuer. The last full valuation of the Authority's dwelling took place on 1 April 2014 and a desktop review will be performed at 31 March 2017. All other assets included within other land and buildings are revalued on a rolling basis each year. As revaluations occur up to every five years, the time delay could result in a material difference between the carrying value and fair value.

Significant audit risks

Our *External Audit Plan 2016/17* sets out our assessment of the Authority's significant audit risks. We have completed our testing in these areas and set out our evaluation following our work:

Significant audit risks	Work performed
Valuation of Property, Plant & Equipment (PPE) (continued)	**Our work to address this risk** As part of our audit work, we assessed the processes the Authority has in place for valuations and confirmed that these were appropriate and that the valuations of property assets were made using reasonable assumptions. This included assessing the Authority's consideration of property value movements between the date of property valuation and the balance sheet date and indicators if impairment of assets. We have also evaluated the expertise of the preparer of the valuation report to ensure that they are sufficiently skilled and appropriately qualified such that we can rely on them for the provision of audit evidence. No issues were identified as a result of the above work.

Considerations required by professional standards

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 2016/17* 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.

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

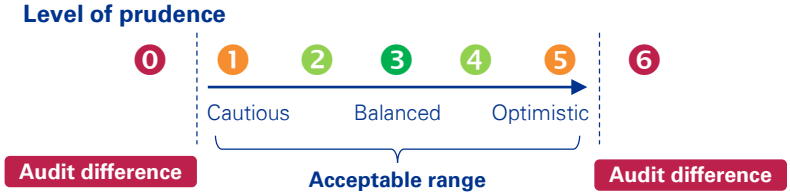
Other areas of audit focus

We identified one other area of audit focus. These are not considered as significant risks as they are less likely to give rise to a material error. Nonetheless these are areas of importance where we carry out substantive audit procedures to ensure that there is no risk of material misstatement.

Other areas of audit focus	Our work to address the areas
Disclosures associated with retrospective restatement of CIES, EFA and MiRS	**Background** CIPFA has introduced changes to the 2016/17 Local Government Accounting Code ("the Code"): — Allowing local authorities to report on the same basis as they are organised by removing the requirement for the Service Reporting Code of Practice (SeRCOP) to be applied to the Comprehensive Income and Expenditure Statement (CIES); and — Introducing an Expenditure and Funding Analysis (EFA) which provides a direct reconciliation between the way local authorities are funded and prepare their budget and the CIES. This analysis is supported by a streamlined Movement in Reserves Statement (MiRS) and replaces the current segmental reporting note. The Authority was required to make a retrospective restatement of its CIES (cost of services) and the MiRS. New disclosure requirements and restatement of accounts require compliance with relevant guidance and correct application of applicable accounting standards. **What we have done** For the restatement, we obtained an understanding of the methodology used to prepare the revised statements and confirmed that it was in accordance with the accounting standards. We have also agreed figures disclosed to the Authority's general ledger and found no issues to note.

Judgements

We have considered the level of prudence within key judgements in your 2016/17 financial statements and accounting estimates. We have set out our view below across the following range of judgements.



Subjective areas	2016/17	2015/16	Balance	Commentary
Debtors Provisioning	4	3	CY: £3.3 million PY: £3.4 million	The Authority have a debtors balance of £17.2 million (PY: £14.0 million), within this balance there are Sundry Debtors worth £13.7 million (PY: £9.8 million). We noted that despite £2.9 million of debts aged over 120 day the council have only provided for £1.4 million of this debt. Some of the debts are aged up to 20 years old. A recommendation has been raised to review the recoverability of the debtors balance, please see Appendix One.
Pension Liability	4	3	CY: £121.0 million PY: £89.4 million	We have reviewed the actuarial assumptions for the current financial year and noted the following; The discount rate used is considered less prudent than the KPMG expected assumption but consistent with the approach taken last year and within the acceptable tolerance range. This less prudent approach therefore places a lower value on liabilities. The Pension increases (CPI)assumptions are considered more prudent than our expected assumption, however the methodology is reasonable and consistent with prior year. The salary increase and mortality assumptions were both considered consistent and reasonable. Overall, the net discount rate (i.e. the discount rate less CPI inflation) are within our tolerable range despite both individually being towards the extremes of our acceptable ranges. Therefore we consider the assumptions in combination to be reasonable.
PPE: Asset lives/ Valuation	3	3	CY: £346.8 million PY: £390.5 million	The Authority continues its use of the beacon methodology in line with the DCLG's *Stock Valuation for Resource Accounting* published in November 2016. The Authority has utilised a valuation expert to provide valuation estimates. We have reviewed the instructions provided and deem that the valuation exercise is in line with the instructions. The resulting increase is in line with industry standard indices. We have also compared the regional adjustment factor used as part of the Beacon Valuation methodology to the DCLG guidance. A full valuation is performed on a rolling basis to cover 20% of assets per annum over a five-year cycle. Assets not included in the full valuation are also assessed in order to ensure that carrying amounts are not materially different to current values at the year-end. We have critically assured the judgements involved with no issues noted.

Proposed opinion and audit differences

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's 2016/17 financial statements following approval of the Statement of Accounts by the Audit Committee on 20 September 2017.

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 level for this year's audit was set at £1.9 million. Audit differences below £0.1 million are not considered significant. See Appendix Four for more information on materiality.

We did not identify any material misstatements. We identified a number of issues that have been adjusted by. These adjusted differences have been set out in Appendix Three.

The tables on the right illustrate the total impact of audit differences on the Authority's movements on the General Fund and HRA for the year and balance sheet as at 31 March 2017.

In addition, we identified a number of presentational adjustments required to ensure that the accounts are compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 ('the Code'). We understand that the Authority will be addressing these where significant.

Annual governance statement

We have reviewed the Authority's 2016/17 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 have made a number of comments in respect of its format and content which the Authority has agreed to amend where significant.

Narrative report

We have reviewed the Authority's 2016/17 narrative report and have confirmed that it is consistent with the financial statements and our understanding of the Authority.

Movements on the general fund 2016/17

£m	Pre-audit	Post-audit	Ref[1]
Surplus/Deficit on the provision of services	13.9	13.9	
Adjustments between accounting basis and funding basis under Regulations	1.1	1.1	
Transfers to earmarked reserves	0	0	
Increase in General Fund and HRA	**1.3**	**1.3**	

Balance sheet as at 31 March 2017

£m	Pre-audit	Post-audit	Ref[1]
Property, plant and equipment	390.6	390.6	
Other long term assets	81.1	81.1	
Current assets	39.2	39.5	1
Current liabilities	(25.3)	(25.6)	1
Long term liabilities	(188.2)	(188.2)	
Net worth	**297.4**	**297.4**	
General Fund	(5.3)	(5.3)	
Other usable reserves	(37.4)	(37.4)	
Unusable reserves	(254.7)	(254.7)	
Total reserves	**297.4**	**297.4**	

[1] See referenced adjustments in Appendix Three.

Accounts production and audit process

Our audit standards (*ISA 260*) require us to communicate our views on 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. The efficient production of the financial statements and good-quality working papers are critical to meeting the tighter deadlines.

Accounting practices and financial reporting

The Authority has recognised the additional pressures which the earlier closedown in 2017/18 will bring. We have been engaging with the Authority in the period leading up to the year end in order to proactively address issues as they emerge.

We consider the Authority's accounting practices appropriate,

Completeness of draft accounts

We received a complete set of draft accounts on 25 May 2017, far ahead of the statutory deadline.

Quality of supporting working papers

We issued our *Accounts Audit Protocol 2016/17* ("Prepared by Client" request) in January 2017 which outlines our documentation request. This helps the Authority to provide audit evidence in line with our expectations.

We worked with management to ensure that working paper requirements are understood and aligned to our expectations. We are pleased to report that this has resulted in good-quality working papers with clear audit trails.

Response to audit queries

We expect that where possible, audit enquires have a turnaround time of two working days. We are pleased to report that this was achieved by Officers, including those who are not part of the finance team. As a result of this, all our audit work is expected to be completed within the timescales agreed. At current, the following areas are ongoing:

- Updating our assessment of subsequent events;
- Receipt of the management representation letter; and
- Receipt and review of the final version of the financial statements.

Prior year recommendations

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

The Authority has implemented one of the three recommendations raised in our ISA 260 Report 2015/16. However we did note significant progress in the Procurement recommendation.

Appendix Two provides further details.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's 2016/17 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 Council for the year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and Exeter 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 Five 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 David Hodgson 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 or our previous reports relating to the audit of the Authority's 2016/17 financial statements.

Section three

Value for money

Our 2016/17 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 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.

The qualification is as a result of weaknesses in the procurement process, although we do note that progress has been made since the 2015/16 audit.

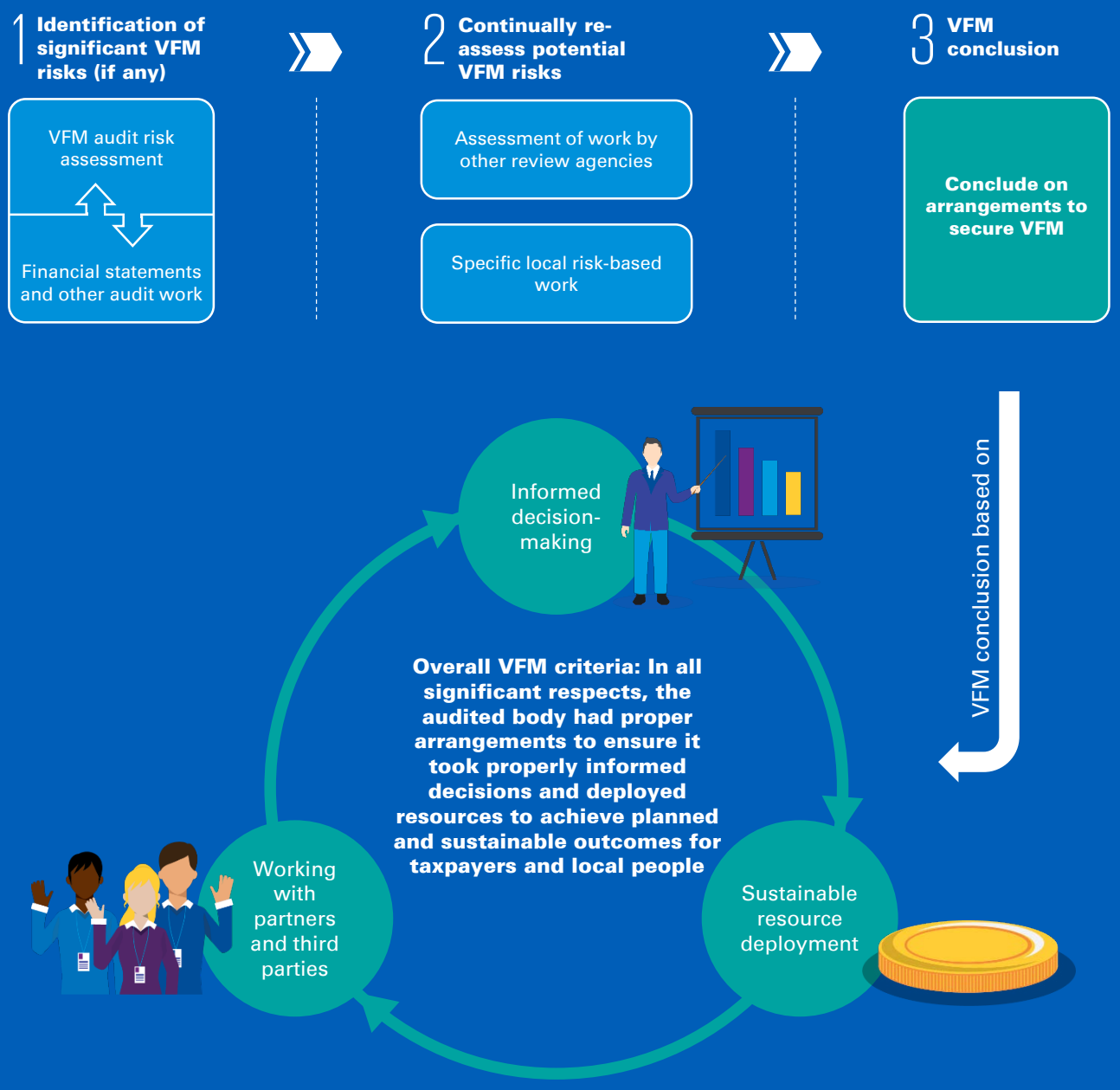
VFM conclusion

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.'

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.



VFM conclusion - headline results

The table below summarises our assessment of the significant VFM audit risk identified against the three sub-criteria. This directly feeds into the overall VFM criteria and our value for money opinion.

VFM assessment summary

VFM risk	Informed decision-making	Sustainable resource deployment	Working with partners and third parties
1. Non-Compliance with procurement process	✓	✓	✗
2.New development of leisure centre and bus station	✓	✓	✓
3.Impact of performance of Strata Service solutions on the authority	✓	✓	✓
Overall summary	✓	✓	✗

In consideration of the above, we have concluded that in 2016/17, the Authority has made proper arrangements to ensure it took properly-informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. However the progress made on the issues on procurement has not been sufficient for a clean opinion for the 2016/17 year.

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; and
- Performed testing over the identified risk areas during our final audit visit.

Further details on the work done and our assessment are provided on the following pages.

Significant VFM risks

We identified one significant VFM risk, as communicated to you in our *2016/17 External Audit Plan*. 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.

Significant VFM risks	Work performed
1. Non-compliance with procurement process	**Why is this a risk?** In the previous year we undertook significant work to consider the Council's procurement arrangements. The Council itself recognised the need for these to be strengthened in its Annual Governance Statement. We qualified our VFM conclusion on an 'except for' basis as a result of weaknesses identified in these arrangements. The Council developed an action plan to address the issues and has been working on delivering improvements in its procurement arrangements. **Summary of our work** We reviewed the progress against the action plan that was presented to KPMG in the prior year. The council agreed to the following actions: • Consideration of the costs of contracting the services to an external supplier or continue 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; and • Develop an effective training plan. *Progress* The council have progressed on the action plan including: • The council concluded on an in house procurement department including a head of procurement and a procurement officer. They are currently incharge of driving the procurement process and work closely with all other departments. The council looks to continue to grow this function; • The council are in the process of developing a supplier list. They have begun an extensive application process where suppliers are invited to become an approved supplier. They have also developed a bid evaluation process which the procurement team are extensively involved in to assist departments with the procurement process; • The procurement strategy is in progress and has been evaluated against the local government national strategy, scoring an overall average rating. One area that was highlighted as requiring improvement were sharing of performance data with other councils; and • The training plan has begun although also a work in progress, as the procurement team look to assist departments in the procurement process.

Significant VFM risks

Significant VFM risks	Work performed
1. Non-compliance with procurement process	**Summary of our work (continued)** *Testing* We completed sample testing over 17 suppliers. We noted the following: • All of the suppliers tested, that were first used by the Council in 2016/17 had sufficient arrangements and followed procurement process; • Contracts from the previous year which were under review by the procurement team have deemed to have signed contracts or other suitable arrangements in place; • KPMG reviewed the three largest contracts by turnover. One of these contracts was a five year contract which expired in 2015 and the council have continued to charge based on the expired contract; and • KPMG reviewed eight contracts from the previous years testing which had were deemed to have had insufficient arrangements. Five of these contracts now have sufficient arrangements in place however the Council were not able to provide evidence for remaining three contracts. We have identified the following areas for improvement: • There is still some evidence that procurement is failing to follow the established process, with some purchases being made without purchase orders or a Tender process; • The council has not kept track renewal of all existing contracts and in some cases are operating on expired terms; • Some suppliers had multiple supplier codes as a result of change in details. There is a risk that some expenditure above £50k may not be recognised as the cumulative expenditure has been split; and • The Council is yet to establish an formal process for comparison of spend against contract. Currently reports are generated from the ledger, but are not regularly compared against original contract terms. Although there are stringent budget controls in place which note significant overspends on contract. Changes in the process have been implemented, and significant resource has been spent on the action plan, however we the council have further progress to make to fully embed the new process into the culture within the Council. We have there 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.

Significant VFM risks

We identified one significant VFM risk, as communicated to you in our *2016/17 External Audit Plan*. 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.

Significant VFM risks	Work performed
2. New development of leisure centre and bus station	**Why is this a risk?** 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 a considerable project for the Council and is relevant to the sustainable resource deployment and working with partners and third parties sub-criteria of the VFM conclusion. **Summary of our work** The Council has put out a tender for the bus station and leisure centre. The responses were £12 million above the initial budget. As a result the council terminated the contract of the initial consultant, £0.6 million had been spent on the original consultant at this point. The Council took measures to reassess the project, including engaging a new consultant, as a result £12 million increase was reduced to £7 million. The additional expenditure has been approved by both the Executive Board and Council. The project leaders have consulted been in consultation with various parties and have established a risk register and mitigation in place. KPMG have made the assessment that the Council have suitable arrangements to secure value for money on this project.
3. Impact of the performance of Strata Service Solutions on the Authority	**Why is this a risk?** The ongoing savings had been lower than initially expected, and there have been delays on the services provided. This is relevant to the sustainable resource deployment and working with partners and third parties sub-criteria of the VFM conclusion. **Summary of our work** Strata achieved and exceeded the targeted savings in the year and have provided detailed reasons. Strata have established a new business strategy in which Strata funds will only be used to fund agreed upon projects. If any council require additional Strata work they should fund the projects from the Council funds. The Chief Operating Officer resigned in February 2017, however was suitably replaced with a new IT Director. 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.

Appendices

Key issues and recommendations

Our audit work on the Authority's 2016/17 financial statements have identified a number of issues. The summary of these issues have been included here

The Authority should closely monitor progress in addressing the risks, including the implementation of our recommendations. We will formally follow up these recommendations next year.

Each issue and recommendation have been given a priority rating, which is explained below.

High priority — 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.

Medium priority — 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.

Low priority — Issues that would, if corrected, improve internal control in general but are not vital to the overall system. These are generally issues of good practice that we feel would benefit if introduced.

The following is a summary of the issues and recommendations raised in the year 2016/17.

2016/17 recommendations summary

Priority	Total raised for 2016/17
High	1
Medium	3
Low	0
Total	**4**

Medium priority

1. Payroll

Review of payroll is carried out by staff who have write-access to both payroll and HR. As such, segregation of duties is not sufficiently robust for the control to be considered well designed and implemented.

Signatures on starters/leavers authorisations forms from line managers were found to be illegible and the payroll manager was unable to confirm the identity of some signatures. As such, the "manager authorisation" of starters and leavers is undermined.

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.

The starters and leavers forms should have the name and surname of the authorising line manger to ensure that this is legible and the authorisation can be confirmed.

Management response

As part of Strata's convergence programme, ECC is currently working on installing a new HR/Payroll system to go live early 2018. We will ensure that this system caters for the segregation of duties requested. Until this work is finalised, the HR Transactional Services Manager will continue to review the exception report before the payroll is sent for processing.

As requested, the starters and leavers forms will be amended to include the name and surname of the authorising line manager to ensure that this is legible and the authorisation can be confirmed.

Owner - City Solicitor & Head of HR Services

Deadline- April 2018

Key issues and recommendations (continued)

High priority

2. Procurement process

We found evidence that council is not consistently following the procurement process when purchasing supplies and services. A purchase order should be raised, which is then matched to the purchase invoice once received. However we noted the following exceptions:

- An email or a verbal agreement may be made to agree receipt of goods or services. The verbal agreement and email cannot be agreed back as proof of receipt of goods or services in a three way match. The constitution of the council states that a three way match requires that the purchase order be matched to the goods received note and purchase invoice.
- If the purchase invoice does not match the purchase order, then purchase order can retrospectively adjusted to agree to the purchase invoice.
- Not all purchase invoices are raised through the purchase order system. The requestor can call the supplier and make an order. The purchase invoice is received by the accounts payable team and allocated to the department, at which stage the invoice must be authorised by the appropriate person prior to a payment being made. This effectively bypasses the Purchase order process.

We also noted from our VFM work that there are still suppliers which are not on contracts or using outdated contracts. We understand this is work in progress within the procurement team.

Recommendation

The Council should ensure that all departments are aware of the details of procurement process and how to follow the procurement process. They should ensure that all documents have been received and matched prior to making payments.

A purchase order should not be adjusted to agree to the invoice, if a goods received note is retained it would account for any adjustments between the PO and the purchase invoice received.

The Council should continue to progress the procurement action plan, taking note of the issues raised in this report.

Management response

Agreed. Finance will determine that the system can work satisfactorily and determine a timetable for implementation. Aim to roll out from 2018-19

Owner- Chief Financial Officer

Deadline- March 2018

Key issues and recommendations (continued)

Medium priority

3. Journals process

The journals authorisation process as identified in the prior year was only implemented in July 2016 and came into full operation from October.

However on review of journal postings we noted that the finance team have two user profiles one in line with their job title and another as a superuser. We identified 14 instances where superuser access was used to prepare journals, although none of these instances were to self approve a journal.

We reviewed the journals report to ensure that no user prepared and approved their own journals above the £5,000, those under this amount are unapproved. We identified a small number of cases where this had occurred. The council have implemented a mitigating control to review every journal over this threshold, although errors do occur and the preparer is expected to email the approver to acknowledge review.

The system will allow a member of the team to change the journal coding after the journal has been authorised, the approver is not alerted to these changes by the system.

Recommendation

Superuser access should be given to those who require access. The members of the team who are required to prepare journals related to cash should have these rights added to their user profile.

The finance team should review the journals report regularly and follow up on any journals that have been prepared and approved by the same user and ensure that the approver has been notified.

The approver should only approve a journal once they have reviewed and are satisfied with the account coding to prevent the need for the preparer from going back to change the coding.

Management response

The new journal authorisation controls were fully introduced from October 2016 following an initial four month trial period. The Finance Team will review the journals report on a quarterly basis and review any journals over £5,000 that have been prepared and approved by the same user. Journals below £5,000 will be authorised retrospectively, with a random sample of journals reviewed in order to ensure the journal controls are working effectively.

The Finance Team will cease using the Transaction Transfer Facility in respect of journal entries, as the approver is not alerted to the changes. Instead, any transfers will be made by the input of a separate journal.

The Systems Accountant will review the access permissions for the System Administration role and identify whether the removal of journal permissions will impact on the ability to upload interface files. Subject to this, the access permissions will be updated to remove the ability to post journals. In the mean-time, journals over £5,000 will require separate approval prior to posting and System Administrators (super users) will be reminded to input journals under their individual user profile.

Owner – Technical Accounting Manger

Deadline- January 2018

Key issues and recommendations (continued)

Medium priority

4. Provision for bad debt

The Authority have a debtors balance of £17.2 million (PY: £14.0 million), within this balance there are Sundry Debtors worth £13.7 million (PY: £9.8 million). We noted that despite £2.9 million of debts aged over 120 day the council have only provided for £1.4 million of this debt. Some of the debts are aged up to 20 years old.

It is Council policy to consider the debt recoverable if there is a payment plan in place, however a review of the invoices shows that many of these debts have not been paid in the last two years, despite a payment plan.

Recommendation

Given the age of the debt outstanding the council should consider reviewing the bad debt provision.

The Council should consider the recoverability of all debts over two years, which are not receiving payment on the payment plans.

Management response

Agreed. Finance will review the debts outstanding and the bad debt policy in time for the end of the financial year.

Owner- Technical Accounting Manager

Deadline- March 2018

Follow-up of prior year recommendations

In the previous year, we raised three recommendations which we reported in our *External Audit Report 2015/16 (ISA 260)*. The Authority has not implemented all of the recommendations. We re-iterate the importance of the outstanding recommendations and recommend that these are implemented by the Authority.

We have used the same rating system as explained in Appendix One.

Each recommendation is assessed during our 2016/17 work, and we have obtained the recommendation's status to date. We have also obtained Management's assessment of each outstanding recommendation. Below is a summary of the prior year's recommendations.

2015/16 recommendations status summary

Priority	Number raised	Number implemented / superseded	Number outstanding
High	3	2	**1**
Medium	-	-	**-**
Low	-	-	**-**
Total	**3**	**2**	**1**

High priority

1. Authorisation of journals

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 original response

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 1stJuly 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.

Owner

Assistant Director of Finance

Original deadline

1 December 2017

KPMG's July 2017 assessment

Fully implemented

The process came to full operation on the 20th October 2016. We have identified additional improvements in the current year.

Follow-up of prior year recommendations (continued)

High priority

2. 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 original response

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.

Owner

Cooperate Manager Legal and HR

Original deadline

31 March,2017

KPMG's July 2017 assessment

No progress

There has been no progress with the recommendation due to resourcing pressures. This has been superseded by recommendation one in the current year.

High priority

3. 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 original response

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.

Owner

Assistant Director Finance

Original deadline

April 2017

KPMG's July 2017 assessment

In progress

The council are still in progress of implementing the control areas identified for improvement have been include as part of the VFM conclusion. This has been superseded by recommendation one in the current year.

Audit differences

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.

A number of amendments focused on presentational improvements have also been made to the 2016/17 draft financial statements. These have been communicated with management and we will confirm these have been changed once we receive the final set of financial statements.

Adjusted audit differences

The following table sets out the significant audit differences identified by our audit of the Authority's financial statements for the year ended 31 March 2017.

Account/disclosure	Adjustment
Note 10 – Subjective Analysis	Internal recharges (£506,000) were disclosure as net in the subjective analysis. There is no net effect to the net cost of services, this adjustment enables consistency within the notes.
Short Term Debtors/Creditors	A Vat Creditor (£327,000) was incorrectly posted to short term debtors. This has been reclassified to short term creditors. There is zero affect on net assets.
Senior officers remuneration	One officer earning over the £50,000 threshold was excluded from the disclosure and has subsequently been included.
Termination Payments	From review of payslips we noted that one officer was in the incorrect bracket.

Unadjusted audit differences

There were no unadjusted audit differences identified by our audit of the Authority's financial statements for the year ended 31 March 2017.

Appendix four

Materiality and reporting of audit differences

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 used the same planning materiality reported in our External Audit Plan 2016/17, presented to you in January 2017.

Materiality for the Authority's accounts was set at £1.9 million which equates to around 1.2% of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision, set at £1.4 million for 2016/17.

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 £95,000 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.

Appendix five

Declaration of independence and objectivity

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 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 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.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Partners and staff annually confirm their compliance with our Ethics and Independence Manual including in particular that they have no prohibited shareholdings.

Our Ethics and Independence Manual is fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through: Instilling professional values, Communications, Internal accountability, Risk management and Independent reviews.

We would be happy to discuss any of these aspects of our procedures in more detail.

Auditor declaration

In relation to the audit of the financial statements of Exeter City Council for the financial year ending 31 March 2017, 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 six

Audit fees

Non-audit work and independence

Below we have listed the non-audit work performed and set out how we have considered and mitigated (where necessary) potential threats to our independence.

Summary of non-audit work			
Description of non-audit service	**Estimated fee**	**Billed to date**	**Potential threat to auditor independence and associated safeguards in place**
Housing Benefits Grants Certification	£15,270	£0	The certification of the Housing Benefits Subsidy return forms part of our contractual responsibilities as the Authority's appointed auditor. The nature of this audit-related services is such that we do not consider it to create any independence threats.
Pooling of Housing Capital Receipts	£3,000	£0	The certification of the Pooling of Housing Capital Receipts forms part of our contractual responsibilities as the Authority's appointed auditor. The nature of this audit-related services is such that we do not consider it to create any independence threats.
Total estimated fees	**£18,720**	**£0**	
Total estimated fees as a percentage of the external audit fees	**32%**		

Audit fees

As communicated to you in our External Audit Plan 2016/17, our scale fee for the audit is £57,887 plus VAT *in 2016/17*, which is a consistent with the prior year. However, an additional fee was required in the previous year due to additional work undertaken in relation to VFM opinion. Our work on the certification of Housing Benefits (BEN01) is planned for August 2017. The planned scale fee for this is £15,270 plus VAT, see further details below.

Fee table		
Component of audit	**2016/17** *(planned fee)* £	**2015/16** *(actual fee)* £
Accounts opinion and use of resources work		
PSAA scale fee (Exeter Council)	57,887	57,887
Additional work to conclude our opinions (relating to VFM work)	0	4,000
Subtotal	**57,887**	**£61,887**
Housing benefits (BEN01) certification work		
PSAA scale fee – planned for August 2017	£15,270	£16,100
Other grants certification work	£3,000	£3,000
Total fee for the Authority	**£76,157**	**£80,987**

All fees are quoted exclusive of VAT.