External audit report 2016/17

Leicester City Council

September 2017

Summary for Audit and Risk Committee

Financial statements

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

This report focusses on our on-site work which will be completed in September 2017 on the Authority's significant risk areas, as well as other areas of your financial statements. Our findings are summarised in Section one.

Subject to all outstanding queries being resolved to our satisfaction we anticipate issuing an unqualified audit opinion on the Authority's financial statements before the deadline of 30 September.

The following matters are currently outstanding at the date of this report:

- Completion of Whole of Government Accounts (WGA);
- Receipt of the management representation letter;
- Post balance sheet events review up to the date of signing the audit opinion;
- Final review of the revised financial statements; and
- Final review following clearance of remaining matters.

Based on our work, we have raised one recommendation, which can be found in Appendix 1.

The majority of recommendations raised in our ISA 2015/16 have been fully implemented. More detail is provided in Appendix 2.

We are now in the completion stage of the audit and anticipate issuing our completion certificate by the deadline of 30 September 2017.

Use of resources

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 and for working with partners and third parties. We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

We therefore anticipate issuing an unqualified value for money conclusion.

See further details in Section two

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 and Risk Committee to note this report.

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Contents

Section one

Financial Statements

We anticipate issuing an unqualified audit opinion on the Authority's 2016/17 financial statements by 30 September 2017. 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 an underspend of £9.67 million against the General Fund budget.

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 - 1. Significant changes in the pension liability due to LGPS Triennial Valuation

Why is this a risk?

During the year, 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 share of pensions assets and liabilities for each admitted body is determined in detail, and a large volume of data is provided to the actuary to support 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 Leicestershire County Council, who administer 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 to note. We have also tested the year-end submission process and agreed pension costs, liabilities and disclosures under IAS19 to confirmations from the scheme actuary.

We have engaged with the Pension Fund auditors to gain assurance over the pension figures.

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

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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 area of audit focus. This is not considered as a significant risk as it is less likely to give rise to a material error. Nonetheless this is an area of importance where we would carry out substantive audit procedures to ensure that there is no risk of material misstatement.

Other areas of audit focus - Disclosures associated with retrospective restatement of CIES, EFA and MiRS

Background

CIPFA has introduced changes to the 2016/17 Local Government Accounting Code (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 have obtained an understanding of the methodology used to prepare the revised statements. We have also agreed figures disclosed to the Authority's supporting working papers 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.

Level of prudence

Subjective areas	2016/17	2015/16	Commentary
Property, plant and equipment (valuations and asset lives)	3	3	PPE is valued at £2,253.4 million (2015/16 £2,143.8 million). Valuations are consistent with information provided by the valuer. The asset lives used in the calculation of depreciation are not unreasonable. .
Pensions liability	3	3	The balance of £655.4 million (2015/16: £530.8 million) represents the deficit on the pension scheme. The reported balance, together with assumptions and disclosures, is consistent with the report from the external actuary.

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 and Risk Committee on 28 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 (see Appendix 4 for more information on materiality) level for this year's audit was set at £15 million. Audit differences below £750,000 are not considered significant.

We did not identify any material misstatements. We identified a number of minor presentational matters that officers have agreed to amend.

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.

Narrative statement

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

Accounts production and audit process

The Accounts and Audit Regulations 2015 introduces a statutory requirement to produce a draft set of financial statements earlier for the year 2017/18. It also shortens the time available for the audit.

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.

The Authority has strengthened its financial reporting by finalising the accounts in a shorter timescale. This puts the Authority in a generally good position to meet the new 2017/18 deadline. We consider that the Authority's accounting practices are appropriate.

Completeness of accounts presented for audit.

We received a set of accounts for audit on 22 June 2017, which is before the statutory deadline of 30 June 2017.

Quality of supporting working papers

We issued our Prepared by Client ("PBC") list in January 2017 which outlines the documentation requested for our audit. This helps the Authority to provide audit evidence in line with our expectations.

We found that the quality of working papers provided was good and met the standards which we have specified.

Response to audit queries

Officers dealt with our audit queries on a timely basis. As a result of this, all of our audit work was completed within the timescales expected with no outstanding queries. This achievement puts the Authority in a good position to take on the 2017-18 earlier closedown with no significant concerns..

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 the majority recommendations from our ISA 260 Report 2015/16. Appendix 2 provides further details.

Controls over key financial systems

We have tested controls as part of our focus on significant audit risks and other parts of your key financial systems on which we rely as part of our audit. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

Below we have highlighted one exception in relation to our testing of controls:

Access rights to IT systems

Our testing identified that the Authority does not perform a periodic check of users access rights to systems, in order to ensure access privileges are appropriate. We have made a recommendation to address this issue – see Appendix 1.

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 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 Leicester City Council for the year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and Leicester 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 5 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 Responsible Finance Office for presentation to the Audit and Risk 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 other 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 two

Value for money

Our 2016/17 VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions, worked with partners and other third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people and for working with partners and third parties.

We have concluded that the Authority has made proper arrangements to ensure it took properly informed decisions, worked with partners and other third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people and for working with partners and third parties.

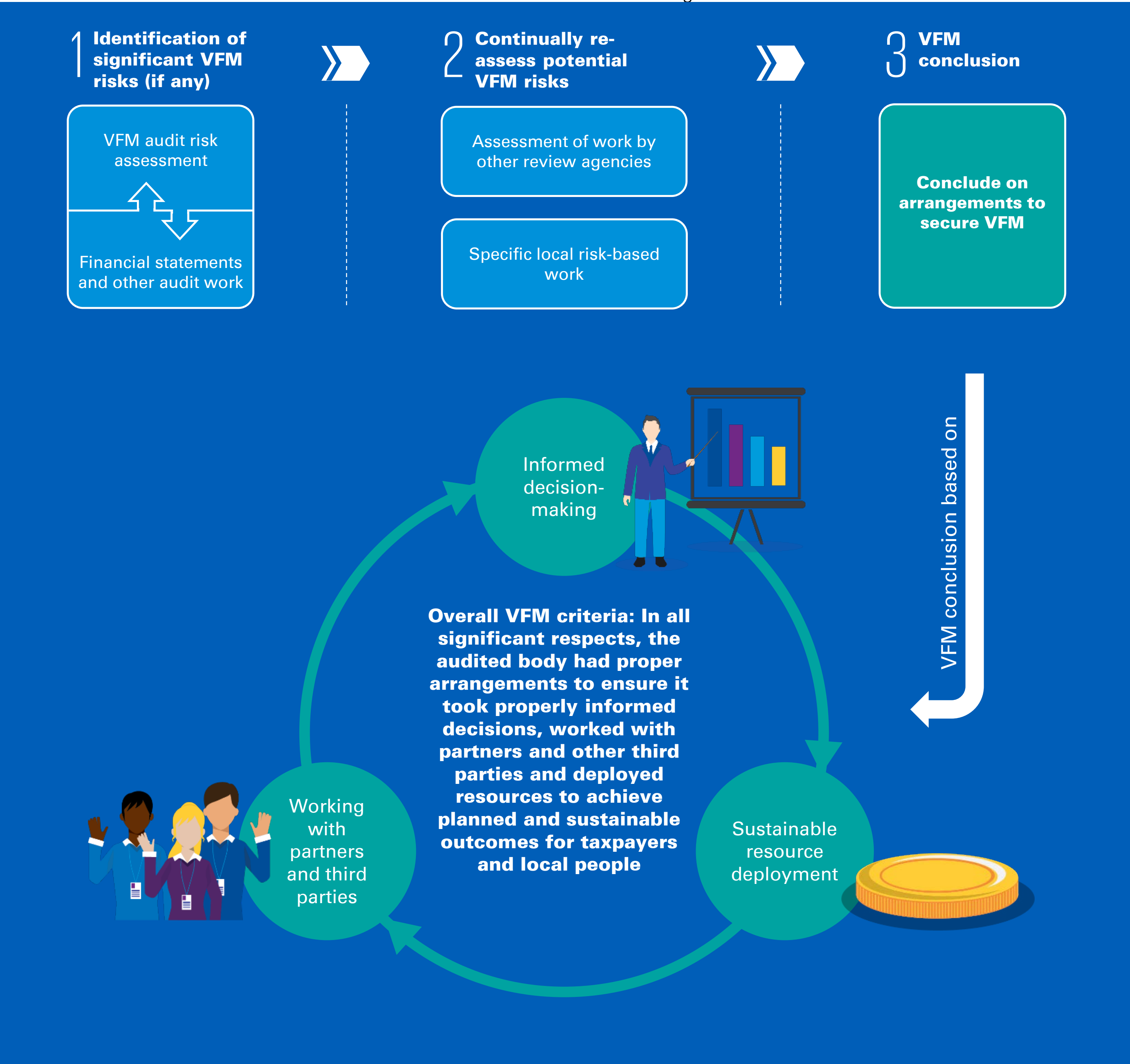
VFM conclusion

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, worked with partners and other third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people and for working with partners and third parties.

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



The table below summarises our assessment of the individual VFM risks 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**
Financial resilience	✓	✓	✓
OFSTED findings – Children's Services	✓	✓	✓
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, worked with partners and other third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people and for working with partners and third parties.

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

Significant VFM risks

We identified two VFM risks, as communicated to you in our *2016/17 External Audit Plan*. We are satisfied that a combination of external and internal scrutiny and our own review provides us with sufficient assurance to enable us to conclude that the Authority's current arrangements in relation to these areas is adequate. Nevertheless, there are significant challenges ahead.

VFM risk – Financial Resilience

Why is this a risk?

In February 2016 the Authority anticipated having to find revenue savings amounting to £55 million per annum by 2019/20. The Authority had set aside a managed reserves fund, but this would be exhausted by March 2018.

As a result of spending reviews undertaken, and a review of earmarked reserves, additional reserves have become available, extending the availability of reserves into 2019. The Authority anticipates that spending reviews approved from now on will extend the strategy further.

While there is an improvement in the overall position, the report presented to Council in February 2017 acknowledges the extent of the issue facing the Authority, with estimated annual savings of £41 million still to be found by 2019/20.

Summary of our work

We have reviewed the Authority's outturn report for 2016/17 and noted the Authority achieved an underspend on the General Fund of £9.6 million against the original budget of £263 million. The Authority has undertaken an analysis of the main areas and reasons for underspending. We also note that the Authority's Housing Revenue Account outturn for 2016/17 was an underspend of £5.8 million.

The Authority has an established reserves strategy, building up reserves over the last three years to allow time to develop the approach to identifying savings. During the year, the reorganisation of departmental earmarked reserve balances and the transfer of £4.9m from earmarked reserves into the Managed Reserve Fund to support the budget strategy was approved. The General Fund stands at £15 million which is the minimum balance recommended by the Director of Finance. The Authority has £172 million in earmarked reserves at year end which is an underlying decline of around £18.3 million in the year. From 2017/18, the Authority plans for reductions in earmarked reserves as it makes investments in transforming services.

We have reviewed Medium Term Financial Strategy (MTFS) income and expenditure assumptions and consider them to be reasonable. The Medium Term Financial Strategy (MTFS) 2017 to 2020 shows a gap in funding of over £58 million up to 2019/20, but the Authority acknowledges that there is a higher underlying gap and that, since there is no allowance for inflation, other than pay awards, that the overall gap for 2019/20 could be higher.

The Authority has effective arrangements in place for managing and delivering its annual budget and has recognised the scale of the challenge going forward and has reported this to Members. It has established appropriate savings programmes and has a track record of delivery against these. The arrangements that the Authority has in place to establish financial resilience are sufficient for an unqualified value for money conclusion.

Significant VFM risks

VFM Risk – OFSTED Findings – Children's Services

Why is this a risk?

In March 2015 OFSTED published a report that concluded "The overall judgement is that children's services are inadequate."

There is a "Dashboard of key indicators" that tracks progress against a range of measures. The dashboard presented to the LCCIB for December 2016 shows 12 out of 19 key performance indicators (KPIs) assessed as good/outstanding, 4 assessed as inadequate, with a further 3 still requiring improvement.

The Authority produces "12 week action plans" that focus on the priorities for the immediate period ahead, to better concentrate the efforts of staff. These are updated regularly and reported to the Leicester City Children's Improvement Board (LCCIB).

Earlier in the year a peer review (Carried out by other Authorities) gave the Authority positive external endorsement of the direction of travel and current practice in relation to safeguarding and child protection.

In January 2017 Ofsted undertook their sixth monitoring visit since the full inspection in early 2015. Inspectors found progress in most of the areas identified in the inspection, and significant progress in some aspects of work to support children in need and children in need of protection. The report also highlighted areas where further improvements are still required.

There is evidence that the Authority is taking on board the comments made by OFSTED from their interim reviews, and is working closely with other 'good' local authorities, external agencies and partners to deliver children's services. Findings from OFSTED monitoring visits and external reviews will be incorporated into a refreshed Improvement plan.

A formal re-inspection by OFSTED is expected to take place later in 2017.

Summary of our work

Last year, we reported that the Authority had put in place an action plan to address the OFSTED findings and had established a "Dashboard of key indicators" that tracks progress against a range of measures. There was evidence that the Authority was taking on board the comments made by OFSTED from their interim reviews, and is working closely with other 'good' local authorities, external agencies and partners to deliver children's services. Findings from OFSTED monitoring visits and external reviews will be incorporated into a refreshed Improvement plan. Whilst recognising that progress had been made, we issued a qualified VFM conclusion to this effect in 2015/16. This year, investment has been made to improve the service. Following a month long inspection in July, OFSTED has removed the inadequate rating for children's services. They have acknowledged that the service overall requires improvement but have rated some aspects of the service as good. Therefore, the Authority is able to demonstrate that arrangements and processes put in place following the initial OFSTED Inspection (March 2015) are appropriate to secure measurable improvements in Children's Services. Consequently, progress to date is sufficient to enable us to remove our historic "except for" qualification to the VfM Conclusion in respect of Children's Services.

We will continue to liaise with key officers at the Council to assess further progress in this area during the 2017/18 audit.

Appendices

Key issues and recommendations

Our audit work on the Authority's 2016/17 financial statements has identified one issue regarding high level IT controls . We have listed this issue in this Appendix together with our recommendation. We have also included Management's response to this recommendation.

The Authority should closely monitor progress in addressing the risk, including the implementation of our recommendation. We will formally follow up this recommendation 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	Number raised from our audit
High	-
Medium	1
Low	-
Total	**1**

Medium priority

1. System access reviews

Periodic reviews of the appropriateness of system access are not carried out consistently for the following systems:

- Agresso
- Civica (Open Revenues)
- Northgate Housing
- Northgate Payroll

There is a risk of inappropriate or unauthorised access to Authority systems and data

Recommendation

A risk-based review of user access privileges is undertaken on an annual basis

Management Response

We will review user access privileges and the process for updating access to systems.

Owner

Service Support Manager

Deadline

31/03/2018

Follow-up of prior year recommendations

In the previous year, we included ten recommendations which we reported in our *External Audit Report 2015/16 (ISA 260)*. The Authority has not yet implemented five out of ten 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 1.

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	-	-	-
Medium	9	4	5
Low	1	1	-
Total	**10**	**5**	**5**

Medium priority

1. CIPFA Code Disclosure Checklist

The Authority did not complete the disclosure checklist that we requested in our audit working paper requirements. The checklist sets out the minimum disclosure requirements in a set of local government accounts.

There is a risk by not completing the formal checklist that not all disclosure requirements have been met. We completed the checklist and found no issues.

Recommendation:
In future complete the disclosure checklist and make it available to audit. Completion of the checklist prior to audit may identify any non-disclosures and enable earlier resolution.

Management original response

Agreed.

We will ensure that completion of the Code Disclosure Checklist is factored into future timetables.

KPMG assessment

The Authority completed the Code Disclosure Checklist and included this in the working papers provided to us.

Fully implemented

Medium priority

2. Leaseholder accounts - housing

Tenants of council flats who exercise their right to buy continue to make contributions towards the general upkeep of the buildings.

The leaseholder accounts team in housing had not reconciled the total or the individual balances in their records(balances represent amounts received from former tenants, not yet spent on repairs) to the general ledger at the year end. The balance in the general ledger was understated by approximately £500k as some amounts had been incorrectly posted to income.

The Authority has made a provision in the accounts to cover the shortfall.

Recommendation

Reconcile the total and individual leaseholder balances held on the Northgate housing system to the balances held on the general ledger on a monthly basis. Investigate any discrepancies.

Management original response

Management accepts this recommendation in respect of the need for more frequent and comprehensive reconciliations. The exact frequency will need to be determined in line with business requirements, but will be regular and will ensure that the position is correctly reconciled and maintained.

KPMG assessment

Periodic reconciliations are not being performed.

Not implemented

Management September 2017 response

The processes for periodic reconciliations are being developed and will be continued to be improved. Annual statements are sent out to leaseholders confirming any outstanding balances at the year end.

Owner

Chief Accountant

Deadline

31/03/2018

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Medium priority

3. Fixed Assets Register (FAR)

The FAR is in an excel spreadsheet format. Our review of the FAR identified a small number of assets where the depreciation calculation formulae had not been copied and therefore the depreciation charge had not been correctly calculated. The depreciation charge of these assets was £861k and the financial statements have been amended.

Recommendation

Ensure the FAR is updated and reviewed annually to ensure the depreciation charge formulae is applied for all assets.

Management original response

The FAR is prepared in detail and reviewed annually but is by its nature a complex tool. Management will ensure that further checking mechanisms are built in where possible, with specific reference to this issue.

In the longer term, we are exploring making greater use of the new finance system to account for fixed assets, and as part of this we will give consideration to ensuring that all elements of the accounting adjustments are included.

KPMG assessment

The Authority have introduced further checks to ensure the depreciation charge formula is applied for all assets.

Fully implemented

Medium priority

4. Notes to the Financial Statements

This recommendation was raised two years ago and assessed this to be partially implemented last year as while disclosure note errors were reduced there remained scope for improvement.

Issue

Non-trivial amendments have been made to a number of notes in the financial statements. These were mainly of a presentational nature

The notes form part of the statements by giving details about entries in the primary statements. It is therefore important that the entries in the notes are fairly stated.

Recommendation

Ensure the accounts closedown timetable includes a robust quality review of the notes.

Management original response

Since 2014/15, we have developed a more detailed project plan for the preparation of the Statement of Accounts. We also introduced weekly closedown meetings for key members of staff to try and ensure that deadlines were met or managed. This timetable was successful in facilitating earlier completion of many tasks and therefore allowed more time for the content of the accounts to be reviewed and cross-checked. We are continuing to build on this process for future years.

KPMG assessment

The Authority introduced further checks in the 2016/17 closedown timetable. This resulted in a further reduction in disclosure note errors identified by audit.

Fully implemented

Medium priority

5. Related party disclosure

This recommendation has been in our ISA 260 since 2012/13.

Issue

In 2012/13 and 2013/14 we reported that related party declarations had not been returned by three councillors and six councillors respectively, with the impact that there may be significant matters undisclosed. For 2014/15, ten councillors did not return their annual declarations.

In 2015/16 two councillors have not returned their annual declaration, of which one has not done so have at least two years

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Recommendation

Publish the names of members who fail to return related party declarations. The Chair of the Audit and Risk Committee may wish to consider what further actions are available

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Management original response

We have repeatedly chased these up.. This was an improvement from the previous year. We feel that further steps are a matter for the Audit and Risk Committee but will be able to facilitate any actions required.

KPMG assessment

In 2016/17 two councillors have not returned their annual declaration, of which one has not done so have for at least three years. The other person is no longer a councilor.

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Not implemented

Management September 2017 response

We have continued to improve procedures and sent reminders. We feel that further steps are now for the Audit and Risk Committee to consider.

Medium priority

6. Journal controls

This recommendation has been in our ISA 260 since 2012/13.

Issue

Although only authorised finance staff can raise journals, and that there is a degree of authorisation through granting appropriate permissions when staff take up posts, there is no check that journals processed are complete or accurate.

Recommendation

Our recommendation was to produce a report of non-routine journals raised by finance staff, and provide evidence that journals are authorised by a senior member of the finance team. This was agreed by officers.

Management original response

We have implemented a control whereby system reports on higher-value journals are available to colleagues at any time, and collated reports are occasionally prepared and distributed. As noted last year, a workflow-based system of authorisation for journals will be a far superior solution to this issue and is being incorporated into the development of the new finance system.

KPMG assessment

There is still no established process for authorising journals. However we understand that a process for authorising journals will be incorporated in the new finance system.

Not implemented

Management September 2017 response

In addition to our current controls the Council's new Finance System will implement a workflow based system of authorisation of journals.

Prior year IT recommendations

Medium priority

1. Starters - Access provision (Network)

After the access request form is completed on the portal, the accounts are automatically created without any further validation over the appropriateness of the requests (i.e. line manager or superior to user).

Without a robust starter process it is possible that users are set up with access to the network without appropriate authorisation. In addition to the risk of information being made available to inappropriate persons, there is a risk that users might have access to functions which are inappropriate given their job description, which could lead to unauthorised activities being performed.

Recommendation

Controls should be added around the starter process to ensure the access requested is appropriate.

This may be complimented by a periodic access review to pick up instances in which users retain a level of access which is inappropriate to their role.

System audit trails should be enabled and reviewed where feasible to ensure that all changes to user access are approved and completed appropriately.

Management original response

We have now added a manual check to the access request form carried out by the ICT Service Desk. This takes place if the form has not been submitted by the manager.

KPMG assessment

A manual check has now been added to the process if the form is not submitted by the manager.

Fully implemented

Low priority

2. Leavers - Access removal (Network)

After the access removal request is completed on the portal, accounts are automatically disabled without any further validation over the appropriateness of the request. As a result, any user can request an account to be disabled, even if it is the account of a direct superior.

Accounts could be disabled based on any user's requests, regardless of the relationship of the user with of the requestor with the user, which could result in business disruption.

Recommendation

Controls should be added around the leavers process to ensure the access revocation request is only done by an appropriate requestor (Superior/HR).

Management original response

This will increase the resource requirement. I do not think this is a big enough risk, as the account isn't deleted, just moved to a holding queue pending delete in 90 days. It would take less than a couple of minutes to revert the action. There is an audit of who requested it and becomes a management issue. This has been in place since January and to date we have no reported incidents.

KPMG assessment

Adequate controls are now in place.

Fully implemented

Medium priority

3. Leavers - Access removal (Network)

We identified 35 leavers (out of a total of 839) who have accessed their Active Directory account after leaving the organisation.

The existence of enabled user accounts of leavers increases the risk of these user accounts being exploited to gain unauthorised access to the system by users who are no longer employed by the Authority and/or by current users should they gain access to leaver accounts.

In the event such accounts are used, it would be difficult to establish accountability for subsequent actions carried out. There is therefore a significant risk of damage or disruption to systems or data, as well as potentially fraudulent activity.

Where users change job roles, there is a risk that they retain an inappropriate level of access which is not commensurate with the requirements of their new job role.

Recommendation

When a user ceases employment, to prevent the unnecessary risk of inappropriate or fraudulent activity, user access should be revoked from all layers (application, network, and database) through which access to programs and data is possible.

This should be performed immediately following each user's leaving date. Where possible, last logon dates should be retained.

Additional reviews may need to be performed to complement the leaver process to ensure that the designed process is operating effectively and any inappropriate access is identified and removed. Where systems permit this, such controls should be automated to reduce the risk of control failures.

Management original response

It is the manager's responsibility to inform IT of changes to a user's employment status. For leavers, there are clear guidelines to follow, which are emailed to the manager from the HR team as part of an exit checklist. The guidelines clearly inform the manager of the importance of deleting the accounts and how to do it.

The guidelines link directly to the appropriate form on the self-help website where the manager can request the deletion of the leavers account. On receiving this request, we automatically disable the account for 90 days. If after 90 days there has been no further requests relating to the account it is automatically deleted.

We also proactively have a monthly leavers report from the HR system that we script and place all users on the list that have not already been deleted and disable them.

We also look for accounts with no activity for 90 days and move them to an on hold container.

As for role changes -this is also the responsibility of the manager to inform us. However in this case, there are no prompts for the manager to do so.

KPMG assessment

During our 2016/17 testing, we identified that access to individual applications had not been removed for leavers in a timely manner; however their Active Directory account had been disabled.

There is a risk of inappropriate or unauthorised access to Council systems and data.

We recommend that the current leaver process is reviewed for possible improvements to prevent this recurring.

Partially implemented

Management September 2017 response

We will review the leaver policy process.

Owner

Service Support Manager

Deadline

31/03/2018

Medium priority

4. Passwords -Authentication (Network)

Windows Active Directory is not configured to force users to change their passwords after a specified number of days.

If users are not forced to change their password regularly, there is a risk that they may have their accounts compromised, which could impact upon the integrity of the system.

Recommendation

Password expiry settings should be configured to ensure that user account passwords are changed on a regular basis. It is recommended to have a password maximum age of 90 days.

Management original response

CESG (the Information Security Arm of GCHQ) recommends that we don't change passwords frequently as it makes them less secure (see article here: https://www.cesg.gov.uk/articles/problems-forcing-regular-password-expiry).

If a user's password had been compromised on a third party website a hacker wouldn't be able to use it from outside the Authority as they would also need access the second factor token.

KPMG assessment

The Council's password policy is outdated and not consistent with current system configuration (which has been amended based upon NCSC guidance).

The password policy should be updated and procedures should be in place to ensure it is adhered to, such as ensuring maximum password age and maximum login attempts before lock-out. The policy should cover the network as well as the following systems:

- Agresso
- Civica (Open Revenus)
- Northgate Housing
- Northgate Payroll

Partially implemented

Management September 2017 response

Update the password policy.

Owner
Service Support Manager

Deadline
31/03/2018

Appendix 3

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 and Risk 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.

Our audit did not identify any material misstatements. A number of minor amendments focused on presentational improvements have been made to the 2016/17 draft financial statements. The Finance team is committed to continuous improvement in the quality of the financial statements submitted for audit in future years.

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 February 2017.

Materiality for the Authority's accounts was set at £15 million which equates to around 1.3 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit and Risk 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 and Risk 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 £750,000.

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 and Risk 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 (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 and Risk 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.

Declaration of independence and objectivity (cont.)

Auditor declaration

In relation to the audit of the financial statements of Leicester City Council for the financial year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and Leicester 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

Declaration of independence and objectivity (cont.)

Non-audit work and independence

Below we have listed the non-audit work performed during 2016/17 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	**Actual fee**	**Potential threat to auditor independence and associated safeguards in place**
Pooling of Housing Capital Receipts claim 2015/16 (performed in 2016/17)	£5,700	**Self-interest**: This engagement is entirely separate from the audit through a separate contract, engagement team and lead partner. In addition, the audit fee scale rates were set independently to KPMG by the PSAA. Therefore, the proposed engagement will have no perceived or actual impact on the audit team and the audit team resources that will be deployed to perform a robust and thorough audit. **Self-review:** The nature of this work is auditing these grant claims. The Pooling of Capital Receipt claim has no impact on the main audit because completed after the audit was completed. Therefore this does not impact on our opinion and we do not consider that the outcome of this work threats to our role as external auditors. Consequently we consider we have appropriately managed this threat. **Management threat:** This work will be audit work only – all decisions will be made by the Authority. **Familiarity**: This threat is limited given the scale, nature and timing of the work. The existence of the separate team for this work is the key safeguard. **Advocacy**: We will not act as advocates for the Authority in any aspect of this work. We will draw on our experience in such roles to provide the Authority with a range of approaches but the scope of this work falls well short of any advocacy role. **Intimidation**: not applicable
Teachers Pensions Return 2015/16 (performed in 2016/17)	£5,500	**Self-interest**: This engagement is entirely separate from the audit through a separate contract, engagement team and lead partner. In addition, the audit fee scale rates were set independently to KPMG by the PSAA. Therefore, the proposed engagement will have no perceived or actual impact on the audit team and the audit team resources that will be deployed to perform a robust and thorough audit. **Self-review:** The nature of this work is auditing these grant claims. The Pooling of Capital Receipt claim has no impact on the main audit because completed after the audit was completed. Therefore this does not impact on our opinion and we do not consider that the outcome of this work threats to our role as external auditors. Consequently we consider we have appropriately managed this threat. **Management threat:** This work will be audit work only – all decisions will be made by the Authority. **Familiarity**: This threat is limited given the scale, nature and timing of the work. The existence of the separate team for this work is the key safeguard. **Advocacy**: We will not act as advocates for the Authority in any aspect of this work. We will draw on our experience in such roles to provide the Authority with a range of approaches but the scope of this work falls well short of any advocacy role. **Intimidation**: not applicable v
Total estimated fees	**£11,200**	
Total estimated fees as a percentage of the external audit fees	**8%**	

Audit fees

Audit fees

As communicated to you in our External Audit Plan 2016-17, our scale fee for the audit is £146,603 plus VAT *(£146,603 in 2015-16)*. However, we propose an additional fee due to further work required in relation to the CIES restatement and the triennial pension revaluation.

Our work on the certification of Housing Benefits (BEN01) is not yet complete. The planned scale fee for this work has been determined by the PSAA, see further details below.

PSAA fee table

Component of audit	**2016/17** *(planned fee)* *£*	**2015/16** *(actual fee)* *£*
Accounts opinion and use of resources work		
PSAA scale fee set in 2014-2015	146,603	146,603
Additional work to conclude our opinions (note 1)	TBC	0
Subtotal	**146,603***	**146,603**
Housing benefits (BEN01) certification work		
PSAA scale fee set in 2014/15 – planned for September/October 2017	52,785	58,505
Additional work to conclude our certification work	TBC	0
Total fee for the Authority set by the PSAA	**199,388**	**205,108**

All fees are quoted exclusive of VAT.

Note 1: Accounts opinion and use of resources work

For 2016/17, we have discussed additional fee in relation to the work undertaken in respect of the CIES restatement and the triennial pension revaluation with the s151 officer. This is still subject to final agreement and PSAA approval.

*** Does not include the additional fee re Note 1**