



Interim Audit Report 2016/17



ROTHERHAM MBC

DRAFT

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This document summarises the key findings arising from our work to date in relation to the audit of the Authority's 2016/17 financial statements and the 2016/17 VFM conclusion

Scope of this report

This report summarises the key findings arising from:

- our interim audit work at Rotherham Metropolitan Borough Council ('the Authority') in relation to the Authority's 2016/17 financial statements; and
- our work to support our 2016/17 value for money (VFM) conclusion up to June 2017.

Financial statements

Our *External Audit Plan 2016/17*, presented to you in March 2017, set out the four stages of our financial statements audit process.

During March and April 2017 we completed our planning and control evaluation work. This covered:

- review of the Authority's general control environment, including gaining an understanding of the Authority's IT systems and testing general IT controls;
- testing of certain controls over the Authority's key financial systems;
- review of relevant internal audit work which we are seeking to rely upon; and
- review of the Authority's accounts production process, including work to address prior year audit recommendations and the specific risk areas we have identified for this year.

VFM conclusion

Our *External Audit Plan 2016/17* explained our risk-based approach to VFM work, which is set out in the Code of Audit Practice and supporting guidance published by the NAO and detailed our initial risk assessment.

We have completed some initial work in response to the risks identified during our interim visit.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our interim audit work in relation to the 2016/17 financial statements.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1. We have also reviewed your progress in implementing prior recommendations and this is detailed in Appendix 2.

Acknowledgements

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



This table summarises the headline messages from our work to date. The remainder of this report provides further details on each area.

Organisational and IT control environment	<p>The organisational and IT control environment is generally sound, however we have raised recommendations in the following areas:</p> <ul style="list-style-type: none"> - Timely removal of leavers from IT systems - Appropriate approval of new joiners onto IT systems - Segregation of duty over the preparation and approval of journals
Controls over key financial systems	<p>Controls over key financial systems are sound and we have not identified any issues to report.</p>
Accounts production and specific risk areas for the Authority	<p>We have worked closely with the finance team to confirm that they have appropriate processes in place to ensure the accounts and associated working papers are produced in accordance with reporting deadlines and our audit timeline, given that key members of the finance team have retired. To date we are satisfied that the finance team have plans in place to deliver the accounts on time.</p>
VFM risks	<p>We have identified two significant VFM risks in 2016/17:</p> <ul style="list-style-type: none"> - Governance arrangements - Reserves and financial position. <p>We have undertaken some work to date in response to these risks and have provided our current conclusions below:</p> <ul style="list-style-type: none"> - Governance Arrangements: Overall, indications from our work to date suggest that, arrangements in response to the improvement plan have been implemented, however we are still forming our conclusion on the embeddedness of arrangements throughout the year. Over the next few weeks we will be challenging management to demonstrate the degree of embeddedness of governance arrangements throughout the year. See further detail on page 10. - Reserves and Financial Position: At the time of writing the report we have not identified any issues that would indicate that the Council does not have proper arrangements in place to deploy resources on a sustainable basis, however we note that we still have some detailed work to complete in this area.

Organisational and IT control environment



Your organisational and IT control environment is effective overall.

However, we noted a number of areas where further improvements could be made:

- Authorisation of new starter access to IT systems
- Disabling leavers from IT systems
- Segregation of duties in relation to journals

Work completed

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 of these controls.

The Authority relies on information technology (IT) to support both financial reporting and internal control processes. In order to satisfy ourselves that we can rely on the use of IT, we test controls over access to systems and data, system changes, system development and computer operations.

Our testing covers the following IT systems:

- General Ledger (e5)
- Council Tax and Benefits (Northgate)
- Housing Management (UH)
- Payroll (Pse)

Key findings

We consider that your organisational and IT controls are effective overall, but noted a number of areas for further improvement (see Appendix 1 for our recommendations):

- Authorisation of new starter access to IT systems – we identified one instance where a new starter system access form had not been appropriately authorised. We identified one instance where a new starter system access form had been authorised by someone not on the authorisation list.
- Disabling leavers from IT systems – we found two instances where staff had left the Authority, but there had been delays in the appropriate form being sent from HR to IT to disable their access.

- Segregation of duties in relation to journals – Journal authorisation is undertaken outside of the general ledger, meaning there is no automated control to stop journals being posted without authorisation.

These weaknesses mean we will have to undertake additional substantive testing in relation to journals at year end to confirm that only appropriate officers have posted journals and the journals they have posted were correct.

Aspect	Assessment
Organisational controls:	
Management’s philosophy and operating style	3
Culture of honesty and ethical behaviour	3
Oversight by those charged with governance	3
Risk assessment process	3
Communications	3
Monitoring of controls	3
IT controls:	
Access to systems and data	2
System changes and maintenance	3
Development of new systems and applications	3
Computer operations and end-user computing	3

- Keys: 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 all of the key financial systems are generally sound.

Work completed

We review the outcome of internal audit's work on the financial systems to influence our risk assessment of the overall control environment, which is a key factor when determining the external audit strategy.

Where we have determined that this is the most efficient audit approach to take, we evaluate the design and implementation of the control and then 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 your internal auditors' 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

The controls over of the key financial systems are sound, and we have not identified any weaknesses which require reporting.

Financial system	Controls Assessment
Property, Plant and Equipment	3
Cash and Cash Equivalents	3
Pension Assets and Liabilities	3
Non pay expenditure	3
Payroll	3
Housing benefit expenditure	3
Business rates income	3
Council tax income	3
HRA	3

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

Accounts production process



The Authority's overall process for the preparation of the financial statements is adequate.

Accounts production process

We issued our Accounts Audit Protocol to the Finance Team in April 2017. This important document sets out our audit approach and timetable. It also summarises the working papers and other evidence we require the Authority to provide to support our audit work. We discussed our requirements in detail in a meeting on 20 April 2017.

We continue to meet with the finance team on a regular basis to support them during the financial year end closedown and accounts preparation.

Key findings

We consider that the overall process for the preparation of your financial statements is good. As outlined in our audit plan, the significant changes to the finance team is an area of concern this year, due to the loss of staff with extensive experience in preparing the accounts. However, we have worked closely with the finance team to date and are currently satisfied with the plans they have put in place to deliver the accounts and associated working papers in line with our audit timeline.

Specific audit risk areas and areas of audit focus



The Authority has a good understanding of the key audit risk areas we identified and is making progress in addressing them.

However, these still present significant challenges that require careful management and focus. We will revisit these areas during our final accounts audit.

Financial statements risk work completed

In our External Audit Plan 2016/17, presented to you in March, we identified the key audit risks affecting the Authority's 2016/17 financial statements.

Our audit strategy and plan remain flexible as risks and issues change throughout the year. To date there have been no changes to the risks previously communicated to you.

We have been discussing these risks with the Director of Finance and Finance Team as part of our regular meetings. In addition, we sought to review relevant workings and evidence and agree the accounting treatment as part of our interim work.

Key findings

As part of our plan we identified the following areas of significant audit risk:

- Significant changes in the pension liability due to LGPS triannual valuation;
- Valuation of waste management PFI; and
- Changes in finance team staff.

We continue to work with the Authority to appropriately address these risks. The first two risk areas will be covered by our year end audit work as outlined in our audit plan. The final risk is an ongoing issue until the completion of the audit, although to date we have not identified any areas of concern.

Areas of audit focus

Within our audit plan we identified disclosures associated with retrospective restatement of CIES, EfA and MiRS as an area of audit focus. We have discussed the changes with the finance team, and reviewed their output to date. We are satisfied that the Authority has made appropriate arrangements to ensure the year end figures are not materially misstated. We will audit the disclosures in detail as part of the year end audit process.

Section four – VFM conclusion

Specific VFM risks

We have identified a number of specific VFM risks.

In some cases 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.

We will carry out additional risk-based work in the following areas:

- Governance arrangements
- Reserves and financial position

We have undertaken some work to date in response to these risks.

Work completed

We have

- Assessed the Authority's key business risks which are relevant to our VFM conclusion;
- Identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;
- Considered the results of relevant work by the Authority, other inspectorates and review agencies in relation to these risk areas; and
- Concluded to what extent we need to carry out additional risk-based work.

Key findings

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

We will report our final conclusions in our *ISA 260 Report 2016/17*.

Specific VFM risks

We have identified a number of specific VFM risks.

In some cases 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.

We will carry out additional risk-based work in the following areas:

- Governance arrangements
- Reserves and financial position

We have undertaken some work to date in response to these risks.

Governance Arrangements

- Risk (as per the audit plan presented in April)

The 'Report of Inspection of Rotherham Metropolitan Borough Council' (Casey Review) highlighted serious failings across the Authority in relation to governance. Five Commissioners were appointed by the Government in February 2015 to manage the Council. In February 2016 some decision making powers were returned to the Council following Government agreement that services were of predominantly good quality, well-run and have strong leadership in place. Housing, education, public health, planning, highways, leisure, cultural services and planning policy, along with control of budgeting in these areas, were returned to the control of Rotherham Council's Cabinet. Licensing powers were returned to the Authority in December 2016, with further powers set to return in March 2017.

The Authority continues to implement the actions within their improvement plan to address the concerns raised in the corporate governance report.

Given that the Authority regained part control in 2016, we will need to consider whether the new arrangements were sufficiently embedded throughout 2016/17 to impact on the Council's ability to achieve value for money.

- Interim/Preliminary assessment and work undertaken

At the time of reporting the Commissioners are still responsible for the following functions:

- Children's Services – The report to the Secretaries of State notes that 'Progress continues but there remains further work to do to ensure all individual work is done to a good standard.'
- Asset Management - Commissioners have issued a formal statement of their expectations for this particular function and its further improvement. An action plan has been developed but will take some months to implement.
- Human Resources (Personnel) - Commissioners have issued a statement of requirements. We note that the Council has appointed a new Head of HR to take forward the required actions.
- Commissioners' duty to appoint statutory officers in the Council – this responsibility will remain with commissioners for a further period.
- The ability to appoint Council representatives to External Bodies – this responsibility is due to be returned to the Council.

Specific VFM risks

We have identified a number of specific VFM risks.

In some cases 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.

We will carry out additional risk-based work in the following areas:

- Governance arrangements
- Reserves and financial position

We have undertaken some work to date in response to these risks.

Governance Arrangements

- Interim/Preliminary assessment and work undertaken (continued)

The number of functions that have been returned to be the responsibility of the Council demonstrates the progress that the Council has made since the initial report was published. The Council has continued to work through the improvement plan and has now developed 'The Rotherham Plan: A new perspective 2025'. This sets out a strategic framework for the Council and its partners. We also note that the return of democratic elections and powers as an important step in this process. However the continued control and influence of the commissioners does indicate a weakness in corporate governance, and the ability for the Council to demonstrate effective arrangements in relation to informed decision making in these areas.

As part of our additional risk-based work, we have held interviews with each member of the Strategic Leadership Team to understand the progress made against the improvement plan and to identify areas where further action is required. It is clear from these meetings that the Council is progressing with the identified actions. However we note that the majority of the Leadership Team have only been in place for a year or less and that a number of functions (see previous page) still remain the responsibility of the Commissioners. The Leadership Team are still in the process of progressing actions to address the issues in their areas. Where actions have already been implemented to address issues, it will take time for these arrangements to become embedded.

Overall, indications from our work to date suggest that, arrangements in response to the improvement plan have been implemented, however we are still forming our conclusion on the embeddedness of arrangements throughout the year. Over the next few weeks we will be challenging management to demonstrate the degree of embeddedness of governance arrangements throughout the year. Although we note the strong position that the Council is in at the end of 2016/17, our conclusion needs to reflect the arrangements that have been in place throughout the year.

Specific VFM risks

We have identified a number of specific VFM risks.

In some cases 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.

We will carry out additional risk-based work in the following areas:

- Governance arrangements
- Reserves and financial position

We have undertaken some work to date in response to these risks.

Reserves and Financial Position

- Risk (as per the audit plan presented in April)

There are significant financial pressures facing the Council at present, and in future years. As at December 2016, the Council had identified an in year revenue overspend of £9.319m. There was also an increasing overspend on Dedicated Schools Grant which totals £5.393m. The majority of the financial pressures relate to Children's Services and Adult Social Care. Over the next two years, the Council needs to reduce its net spend by around £42m, including the need to deliver £24m of budget savings in 2017/18. These financial pressures will have a significant impact on the Council's reserves over the next few years. A Medium Term Financial Strategy was submitted to Council in December which included measures to address the overspend.

- Interim/Preliminary assessment and work undertaken

The Council has now agreed the budget for 2017/18. There has been an increase in Council tax to help relieve the pressure from Adult Social Care and Children's Services. There is a significant savings requirement of around £24m and the Council plans to use £5.3m from reserves.

We will review the Council's performance against the 2016/17 annual plan as we progress through our detailed audit of the financial statements, however we don't expect to identify any issues in relation to this that would impact on our VFM conclusion this year.

The Council has also produced a Medium Term Financial Strategy. We plan to review this and assess whether the key assumptions are in line with our knowledge and expectation of the Council and the wider sector. We will also assess the level of reserves planned to be used during the period, and whether the remaining level will be appropriate for a Council of this size to continue to operate into a sustainable future.

At the time of writing the report we have not identified any issues that would indicate that the Council does not have proper arrangements in place to deploy resources on a sustainable basis, however we note that we still have some detailed work to complete in this area.

Key issues and recommendations

We have identified three audit recommendations around the following areas:

- Appropriate IT authorisation of new starters
- Timely removal of leavers from IT system
- Journals segregation of duties

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

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

We will formally follow up these recommendations next year.

Priority rating for recommendations		
<p>1 Priority one: Issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.</p>	<p>2 Priority two: Issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.</p>	<p>3 Priority three: Issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.</p>

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
1	2	<p>Appropriate IT authorisation for new starters</p> <p>We tested a sample of 25 staff who had been given access to the general ledger. Of these, we identified one instance where there was no evidence of authorisation, and one instance where the person who had authorised the form was not on the authorisation list. Although we subsequently obtained evidence that both lots of approval were appropriate, they still represent a control weakness in the process.</p> <p>There is a risk that a user is granted inappropriate access to the general ledger, which could lead to fraudulent or erroneous postings.</p> <p>Staff should be reminded of the importance of appropriately authorising new joiner system access through completion of the required form. Members of the IT team should only grant a user access when there is an approved signatory authorising the access.</p>	

Key issues and recommendations

No.	Risk	Issue and recommendation	Management response/responsible officer/du e date
2	2	<p>Timely removal of leavers from IT systems</p> <p>We obtained a listing of all active users of the general ledger and compared this to a list of leavers per the HR system. We identified two instances where staff had left the organisation but still had access to the ledger at the date of our testing. We identified one instance where the user had not been disabled from the system, but had been made inactive so they would not be able to access the ledger. From conversations with IT staff, they are generally informed that someone has left the organisation at the end of the month.</p> <p>By not promptly removing user access rights, the Authority is at risk of malicious attack or fraud, especially if a leaver has a grievance with the Authority.</p> <p>Where a member of staff is working their notice, IT should be informed of their leave date in advance of them leaving and arrange for their access to be disabled on their leave date.</p> <p>Where a member of staff leaves with immediate effect, IT should be notified immediately so they can disable user access.</p>	
3	3	<p>Segregation of duty in journals process</p> <p>The authorisation of journals takes place outside of the general ledger (e5) through email approval by a relevant senior staff member. The preparation and posting of journals is performed by the same staff member within e5 with no automatic process for confirming the authorisation or ensuring appropriate segregation of duties is in place.</p> <p>There is a risk that the correct authorisation process is not followed and staff can post journals without them being authorised. It should however be noted that our testing did not identify any instances where this had occurred, hence the low priority recommendation</p> <p>We recommend that the Authority looks into whether the general ledger could be updated to include an authorisation step for journals. We recognise this may have to wait until the next significant ledger upgrade, and as such, until this time, random spot checks should be undertaken by a senior member of the finance team to confirm the process is being appropriately followed. These checks should be recorded and available as audit evidence.</p>	

Appendix 2

Follow-up of prior year recommendations

The Authority has implemented all of the recommendations raised through our previous audit work.

This appendix summarises the progress made to implement the recommendations identified in our Interim and Year End Audit Reports 2015/16 and re-iterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	2
Implemented in year or superseded	2
Remain outstanding	0



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