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

Rotherham Metropolitan Borough Council

08 September 2014

Contents

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

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

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

Section one

Introduction

This document summarises:

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

Scope of this report

This report summarises the key findings arising from:

- our audit work at Rotherham Metropolitan Borough Council ('the Authority') in relation to the Authority's 2013/14 financial statements; and
- our work in relation to the 2013/14 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

Financial statements

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

This report focuses on third and fourth stages of the process: substantive procedures and completion. Our on site work for the substantive procedures stage took place during July and August 2014.

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

VFM conclusion

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

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

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our audit work in relation to the 2013/14 financial statements.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Acknowledgements

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

Headlines

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

Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2014. We will also report that the wording of your Annual Governance Statement accords with our understanding.
Audit adjustments	Our audit has identified no audit adjustments which impact on the face of the financial statements. We identified a small number of minor presentational adjustments. These have all been amended by the Authority.
Key financial statements audit risks	We review risks to the financial statements on an ongoing basis. We identified budget pressures as a specific risk area for 2013/14 during the course of the audit. Our audit testing, to address this audit risk, did not identify any issues.
Accounts production and audit process	The accounts and supporting working papers were of high quality. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales. The Authority has implemented all of the recommendations in our *ISA 260 Report 2012/13* relating to the financial statements.
Control environment	The Authority's organisational control environment is effective overall, and we have not identified any significant weaknesses in controls over key financial systems. We are satisfied that we can place reliance on the work of internal audit and have been able to place reliance on their work where this was relevant to our work.
Completion	At the date of this report our audit of the financial statements is substantially complete, subject to: ■ Receipt of approved financial statements; and ■ Receipt of a signed management representation letter. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.
VFM conclusion and risk areas	We are considering the impact of the recently published Independent Inquiry into Child Sexual Exploitation in Rotherham. Therefore, at the date of this report, we have been unable to conclude on whether the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Proposed opinion and audit differences

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

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

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

Proposed audit opinion

We anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Audit Committee on 17 September 2014.

Audit differences

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

We did not identify any material misstatements. We identified a small number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting the United Kingdom 2013/14 ('the Code')*. The Authority has amended all of these as required.

We note that since producing the unaudited financial statements the Authority has added a contingent liability note to reflect the fact that it has received a number of claims in relation to child sexual exploitation.

Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

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

Key financial statements audit risks and areas of audit focus

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

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

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

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

Audit Risk	Issue	Findings
Budget Pressures	As a result of the significant financial pressures, there is a risk that the financial statements could be manipulated to improve the financial position.	We have undertaken additional procedures, regarding expenditure cut off and capitalisation, as part of our audit work to address this risk and have found no issues to report.

Area of Audit Focus	Issue	Findings
Digital Region Limited	During this financial year the Authority (and other members of the joint venture agreement) took a decision to close its Joint Venture company, Digital Region Limited (DRL). Significant costs had already been provided for in earlier years, when these costs became accruable under the accounting standard governing provisions (IAS37), so the Authority is confident that there will not be further significant costs in 2013/14. We will review the Authority's estimate of the costs arising from the orderly and managed closure of DRL at the time the Authority's 2013/14 accounts are prepared, commenting on its material accuracy and completeness as needed.	We have reviewed the Authority's estimates of the costs arising from the managed closure of DRL. It is not anticipated that costs will increase compared to the provision accounted for in the 2012/13 financial statements. Therefore this year there has been no increase in the provision. We note this provision is £5.840m (£6.380m in 2012/13) and we note that £0.540m was utilised during the course of the financial year.
Transition to a new general ledger structure	The new general ledger structure was implemented in July 2013. This means that data was migrated mid-year. Additional work will be required during the audit to ensure the completeness and accuracy of the data which has been transferred over to the new ledger structure.	We have reviewed the process of migrating data over to the new general ledger structure. Our review identified appropriate controls in place to ensure the data was transferred accurately. No issues were identified as a result of our work.

Key financial statements audit risks and areas of audit focus (cont.)

Area of Audit Focus	Issue	Findings
Pension valuation	The IAS 19 adjustments and year-end net pensions liability are estimated based on various assumptions provided by the Authority's actuarial advisors. Given the value of the Authority's net pension liabilities at 31 March 2013 (£372 million) and the level of accounting judgement involved, this balance continues to represent significant accounting judgement. During the year, the Local Government Pension Scheme for South Yorkshire (the Pension Fund) has undergone a triennial valuation with an effective date of 31 March 2013 in line with the Local Government Pension Scheme (Administration) Regulations 2008. The Authority's share of pensions assets and liabilities is determined in detail, and a large volume of data is provided to the actuary in order to carry out this triennial valuation. The IAS 19 numbers to be included in the financial statements for 2013/14 will be based on the output of the triennial valuation rolled forward to 31 March 2014. For 2014/15 and 2015/16 the actuary will then roll forward the valuation for accounting purposes based on more limited data. In order to calculate the valuation, data is provided to the actuary. As part of our audit, we will need to agree the data provided to the actuary back to the systems and reports from which it was derived, and test the accuracy of this data. We will liaise with Mercers, who are the auditors of the Pension Fund, where this data was provided by the Pension Fund on the Authority's behalf. The Pension Fund may seek to recharge any additional costs arising from this work. It is therefore critical that the assumptions reflect the profile of the Authority's employees, and are based on the most recent actuarial valuation. It is also important that assumptions are derived on a consistent basis year to year.	We have agreed the data provided to the actuary back to the Authority's systems from which they were derived and found no issues. We have reviewed the assumptions provided by Mercers and these are in-line with our expectations.

We have noted an improvement in the quality of the accounts and the supporting working papers.

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

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

Accounts production and audit process

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

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority continues to maintain a strong financial reporting process and produce statements of accounts to a good standard. This is in the context of having less resource, so represents good performance.
Completeness of draft accounts	We received a complete set of draft accounts on 29 June 2014. The Authority have made a small number of presentational changes as a result of our audit however there have been no changes which we consider to be fundamental.
Quality of supporting working papers	Our *Accounts Audit Protocol*, which we issued on 4 February 2014 and discussed with officers set out our working paper requirements for the audit. The quality of working papers provided was good and met the standards specified in our *Accounts Audit Protocol*.
Response to audit queries	Officers resolved all audit queries in a timely manner.

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 all of the recommendations in our *ISA 260 Report 2012/13*.

We recommended that the Authority ensure it had appropriate arrangements in place to ensure the closure of Digital Region Limited was appropriately managed to reduce the financial impact on the Authority. We have considered this as part of our work on VFM and identified no issues.

Organisational control environment and controls over key financial systems

Your organisational control environment is effective overall.

The controls over all of the key financial systems are sound.

Organisational control environment

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would have implications for our audit.

We 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.

We consider that your organisational controls are effective overall.

Controls over key financial systems

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.

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 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.

Based on the work of your internal auditors and our own testing, the controls over all of the key financial systems are sound.

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

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

Completion

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

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

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

Declaration of independence and objectivity

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

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

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

Management representations

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

We have asked for specific management representation regarding Digital Region Limited.

Other matters

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

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

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

VFM conclusion

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

At the date of this report, we have been unable to conclude on whether the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Background

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

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

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

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

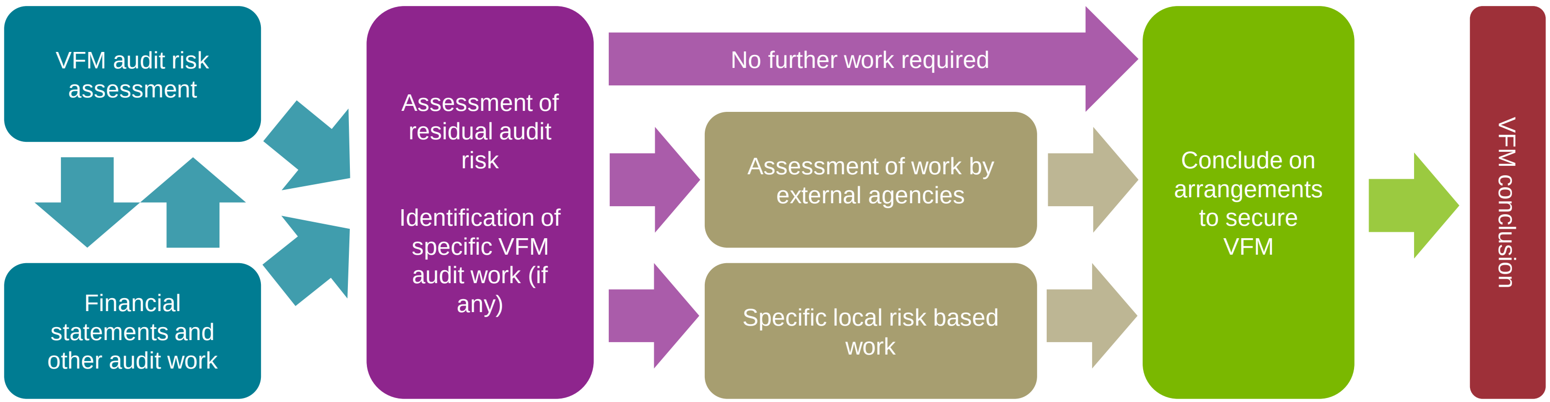
Work completed

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

The following pages include further details of our VFM risk assessment and our specific risk-based work on the risk identified in our audit plan.

Conclusion

We are considering the impact of the recently published Independent Inquiry into Child Sexual Exploitation in Rotherham. At the date of this report, we have been unable to conclude on whether the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.



Section four

Specific VFM risks

We had identified a number of specific VFM risks in our audit plan.

Work completed

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

- assessed the Authority's key business risks which are relevant to our VFM conclusion;
- identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;
- considered the results of relevant work by the Authority, inspectorates and review agencies in relation to these risk areas; and
- completed specific local risk based work in relation to the Authority's involvement in respect of Digital Region Limited and around their saving plans for reductions in future funding.

Key findings

We have set out below the findings in respect of those areas where we have identified a residual audit risk for our VFM conclusion as reported in our audit plan.

Outstanding work

We need to consider the impact of the recently published Independent Inquiry into Child Sexual Exploitation in Rotherham before assessing the impact on our VFM conclusion.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Digital Region Ltd	The Authority (and other members of the joint venture agreement) took a decision to close its Joint Venture company, Digital Region Limited (DRL). The Authority needs to ensure it has appropriate arrangements to ensure the closure of Digital Region Limited is managed to reduce the financial impact on the Authority. This is relevant to both the financial resilience and economy, efficiency and effectiveness criteria of the VFM conclusion.	We have reviewed the work carried out by the Authority in relation to the closure of DRL. The decision to close was taken on a reasonable and evidence based approach and is being managed appropriately. As such, we have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in the closure of DRL.
Saving plans for reduction in funding	The Authority currently estimates that £23 million in savings will need to be achieved during 2014/15. The Authority has developed plans with each directorate in order to make these savings. This has been done by identifying the core priorities for the Authority and ensuring services are aligned with these priorities. Further significant savings will be required in 2015/16 and 2016/17 to principally address future reductions to local authority funding alongside service cost and demand pressures.	We have assessed the controls the Authority has in place to ensure sound financial standing. The Medium Term Financial Plan has taken into consideration the potential funding reductions and it is sufficiently robust to ensure that the Authority can continue to provide services effectively given the funding reductions. We note the Authority has recently reflected a contingent liability for potential claims in relation to child sexual exploitation. The Authority should continue to review the financial impact of these claims and assess the impact on the medium term financial plan to ensure it can secure a stable financial position that enables it to continue to operate for the foreseeable future.

Audit differences

This appendix sets out the significant 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.

Corrected audit differences

We have identified no audit differences which impacted on the face of the financial statements.

We identified a small number of presentational changes to the financial statements, which the Authority has made amendments to correct.

Un-corrected audit differences

We have identified no un-corrected audit differences which impacted on the face of the financial statements.

Declaration of independence and objectivity

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

Requirements

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

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

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

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

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

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from 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's reputation is built, in great part, upon the conduct of our professionals and their ability to deliver objective and independent advice and opinions. That integrity and objectivity underpins the work that KPMG performs and is important to the regulatory environments in which we operate. All partners and staff have an obligation to maintain the relevant level of required independence and to identify and evaluate circumstances and relationships that may impair that independence.

Declaration of independence and objectivity (cont.)

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

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

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

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

Auditor declaration

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

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