



Interim Audit Report 2015/16



South Hams District Council
June 2016

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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 2015/16 financial statements.

Scope of this report

This report summarises the key findings arising from:

- Our interim audit work at South Hams District Council ('the Authority') in relation to the Authority's 2015/16 financial statements
- This report does not cover our 2015/16 value for money (VFM) conclusion. Our work in relation to this will be undertaken during July 2016.

Financial statements

Our *External Audit Plan 2015/16*, presented to you in March 2016, set out the four stages of our financial statements audit process.

During January to May 2016 we completed our planning and control evaluation work. This covered:

- Review of the Authority's general control environment, including the Authority's IT systems;
- Testing of certain controls over the Authority's key financial systems;
- Review of relevant internal audit work which we are seeking to reply 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 2015/16* explained our risk-based approach to VFM work, which is supported by the Code of Audit Practice, published by the NAO in April 2015.

We will complete our work in response to the specific risks identified during our final visit in July. The results of this work will be reported in our ISA 260 Report 2015/16.

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 2015/16 financial statements.

Our recommendations are included in **Appendix 1**.

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. The remainder of this report provides further details on each area.

<p>Organisational and IT control environment</p>	<p>Your organisational control environment is effective overall.</p> <p>The council has appropriate procedures for monitoring budgets, strategic plans and risks, and compliance with its constitution. Sufficient procedures are also in place for identifying related parties and responding to fraud.</p> <p>The IT team and structure in place at the Council has been reduced in size, but provides the key functions that we would expect of such an authority. Our review of Internal Audit's work, however, did suggest that annual disaster recovery exercises have not been performed which, combined with issues identified in relation to the communication and updating of documents in the area of emergency planning. These issues have been raised by Internal Audit and as a result no recommendations are raised in this report.</p>
<p>Controls over key financial systems</p>	<p>In relation to those controls upon which we will place reliance as part of our audit, the key financial systems are generally sound.</p> <p>Despite this, we did identify potential improvements which are detailed further in Appendix 1.</p>
<p>Review of internal audit</p>	<p>Reports and working papers produced by Internal Audit appeared to be of an appropriate standard.</p> <p>In the main, these reports did not relate to the financial controls we sought to rely on for our audit purposes, however, so only limited reliance has been placed upon the work of Internal Audit.</p>
<p>Accounts production and specific risk areas for the Authority</p>	<p>The Authority's overall process for the preparation of the financial statements is strong.</p> <p>The Authority has a closedown schedule in place identifying areas and responsibilities for key areas. We will revisit these areas during our final accounts audit.</p>

Organisational and IT control environment



Your organisational control environment is effective overall.

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.

Key findings

We consider that your organisational controls are effective overall.

Despite this, Internal Audit identified areas where further improvements could be made in relation to:

- The expected annual IT disaster recovery exercise has not been undertaken during the year; and
- Policies, plans and guidance relating to disaster recovery had not been subject to formal review within a reasonable timeframe and access to such has been restricted to the extent that senior leadership may be unable to familiarise themselves with it.

As these matters have already been raised by Internal Audit, we have not included separate recommendations in this report. We understand that an interim Business Continuity Plan has been drafted and presented to the Senior Leadership Team and that the next stage will be to present the policy to the Authority’s Executive in order to explain their roles in a Business Continuity event. The Authority has also become part of the Devon Emergency Planning Service who will be drafting a standardised emergency plan and business continuity plan which will then be adapted to become a local plan, this work should be completed by December.

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	2
IT Environment	3

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



We placed limited reliance on Internal Audit's work on the key financial systems.

Background

United Kingdom Public Sector Internal Audit Standards (PSIAS) apply across the whole of the public sector, including local government. These standards are intended to promote further improvement in the professionalism, quality, consistency and effectiveness of internal audit across the public sector. Additional guidance for local authorities is included in the Local Government Application Note on the PSIAS.

Work completed

The scope of the work of your internal auditors (the Devon Audit Partnership) and their findings informs our audit risk assessment.

We work with your internal auditors to assess the control framework for certain key financial systems and seek to rely on any relevant work they have completed to minimise unnecessary duplication of work. Our audit fee is set on the assumption that we can place appropriate reliance on their work.

Where we intend to rely on internal audit's work in respect of the Authority's key financial systems, auditing standards require us to complete an overall assessment of the internal audit function and to evaluate and test aspects of their work.

The Public Sector Internal Audit Standards define the way in which the internal audit service should undertake its functions. The Devon Audit Partnership updates the internal audit charter and strategy each year. This is subsequently reviewed by the Council's Audit Committee. We have reviewed the latest 2015-16 internal audit charter and strategy and the Audit Committee's subsequent review and approval of this.

We have also reviewed the internal audit function and the reports received at the time of our interim visit.

Key findings

Based on the Audit Committee's review of the internal audit charter and strategy, our assessment of their reports, attendance at Audit Committee and other meetings during the course of the year, we have not identified any significant issues which would indicate internal audit are not compliant with the PSIAS.

We were able to place reliance upon the work of Internal Audit in line with our planned usage for the year.

We are mindful that internal audit try to cover testing that covers the whole of the Authority's financial year and in some instances because of the timing of their work, the close down meetings or draft internal audit reports have not been finalised in time for our interim work.

As a result of this there is a potential that findings will be revised. Where this happens, additional work may be required to meet our own requirements. No such work has been required to date, and we will liaise with the Authority in the event that such a need arises.

Controls over key financial systems



The controls over the majority of the key financial systems are sound. However, there are some improvements noted in Appendix 1.

Work completed

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 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.

We considered that the most efficient approach for this first year audit was to perform our own controls review and testing of the accounts processes on the right. Depending on the process, this involved reviewing reconciliations and other checks, identifying documentation behind individual transactions, and reviewing evidence of arrangements ahead of year-end processes.

Key findings

Based on our work, in relation to those controls upon which we will place reliance as part of our audit, the key financial systems are generally sound. However, we have identified several improvements connected with individual processes as follows:

- There was a lack of evidence of review of reconciliations, following the council's transition to being paperless. It is understood the possibility of using digital signatures is being explored, and we recommend this is pursued where practical;
- We also recommend formal monitoring of the level of 'unmatched' items in each month's cumulative bank reconciliation to further improve cash processes;

- Our consideration of the Council's monthly benefits review noted commentary was lacking in some months, although in each case, the benefits team did 'catch up' in the following month;
- The timeliness of reconciliations between the payroll system and general ledger could be enhanced;
- There was a lack of evidence of consideration of the reconciling items arising following the preparation of the monthly creditor and purchasing reconciliations; and
- Whilst payroll starter and leaver controls were deemed effective, documentation issues were noted regarding incomplete leaver forms.

Financial system	Controls Assessment
Property, Plant and Equipment	3
Cash and Cash Equivalents	2
Pension Assets and Liabilities	3
Non pay expenditure	2
Payroll	2
Housing benefits expenditure	3
Business rates and council tax income	3

- Keys:
- Significant gaps in the control environment.
 - Deficiencies in respect of individual controls.
 - 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 Interim Accounts Audit Protocol to the Director of Finance on 23 February 2016. This document summarises the working papers and other evidence we require the Authority to provide to support our audit work.

We will 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 plans for the preparation of your financial statements is adequate based on our review to date of the year end closedown process.

Specific audit risk areas



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.

Work completed

In our *External Audit Plan 2015/16*, presented to you in March, we identified the key audit risks affecting the Authority's 2015/16 financial statements.

Our audit strategy and plan remain flexible as risks and issues change throughout the year. To date we have identified one additional risk in relation to the Council's provision for non-domestic rates appeals.

We have been discussing these risks with finance officers as part of our meetings. In addition, we will seek to review relevant workings and evidence, and agree the accounting treatment, as part of our final work.

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error.

Significant Risk 1 - Allocation of Shared Costs

— Outline of risk:

The Authority operates a shared service with its neighbour, West Devon Borough Council. As a result of this arrangement, costs are initially borne by each council individually, and then an exercise is undertaken to ensure that these are shared on an appropriate and consistent basis. This is essential to ensuring that the Authority recognises its full costs and to prevent cross subsidy between the two councils. In order to operate effectively, the allocation of costs must be undertaken on an appropriate basis which reflects the nature of the underlying activities and the way in which the resources are consumed.

— Interim/Preliminary assessment and work undertaken:

This risk was discussed at our interim visit. It was established that whilst a number of overheads are relatively straightforward to apportion (for example, using the number of calls in the year), other areas (such as allocating other staff costs) requires more judgement.

Our plan is to review the balances and the bases of apportionment during our year-end visit. We will consider obtaining confirmations from individuals alongside other audit procedures to gain reasonable assurance over the more judgemental apportionment.

Key findings

The Authority has a clear understanding of the risks and 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.

The table below provides a summary of the work the Authority has completed to date to address these risks.

Specific audit risk areas (cont.)



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.

Significant Risk 2 – Non-Domestic Rates Appeals (new)

— Outline of risk:

As a result of the localisation of non-domestic rates, the Council has assumed responsibility in relation to payments arising from valuation appeals. There is currently potentially significant appeals awaiting conclusion in relation to properties located within the Council's boundaries. Whilst the exact outcome is still to be determined, there is a risk that the Council will be liable to significant back payment as well as ongoing reduction to annual non-domestic rates income. As a result the Council's NNDR3 return for 2015/16 includes a significant increase of £26.7m in the appeals provision. Whilst this would be shared with Central Government, Devon County Council and Devon & Somerset Fire & Rescue, the impact on the Council would still be material as the Council receives 40% of non-domestic rates income.

— Interim/Preliminary assessment and work undertaken:

This risk has come to our attention within the last few weeks. As a result, no detailed work has been undertaken to date. We have, however, held preliminary discussions with the Finance Community of Practice Lead (S151 Officer) in relation to this matter.

During our final audit visit we will consider the methodology that the Council has used to calculate its provision for non-domestic rates appeals. We will specifically consider the approach taken in relation to any individually significant appeals and the position of those appeals at the point of signing our audit opinion.

Key issues and recommendations

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

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

We will formally follow up these recommendations next year.

Priority rating for recommendations

1 **Priority one:** Issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.

2 **Priority two:** Issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.

3 **Priority three:** Issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
3	3	<p>Review of Benefit Payments</p> <p>We reviewed the Benefits team's monthly checking of benefits claims and related payments. For each month tested, the spreadsheet extracted from Northgate was appropriately produced. However, the manual checking to supplement these was not always evident.</p> <p>If benefit payments go unchecked, there is a risk that administrative errors in payment could approach more material levels.</p> <p>We did note that in the case of each month we selected where this was noted, checking was performed in the subsequent month.</p> <p>Recommendation</p> <p>Due to business needs, it may be difficult to fully evidence such checks each month, although we recommend that this is performed. It may be possible to assign specific areas of checking to different team members to the extent that no single individual completes a month's checks. This might also enable better segregation of duties.</p> <p>Ensure that the checks are signed off or more formally reviewed in line with our recommendation regarding reconciliations more generally.</p>	<p>Agreed.</p> <p>The Finance Community of Practice team will work with the Benefits team and Case Management (Support Services) team to ensure that all benefit payments to/from the Council are appropriately reconciled and signed off as complete. Evidence of the checks will be maintained. The teams will look to ensure that plans are documented and circulated to responsible officers.</p> <p>The Deputy S151 Officer will also attend the monthly reconciliations meetings with the Case Management (Support Services) team to discuss any issues with implementing the above and to ensure that all of the external audit points are addressed and best practice followed.</p> <p>Responsible Officer</p> <p>Deputy S151 Officer in consultation with the Lead for Case Management (Support Services)</p> <p>Implementation Deadline</p> <p>September 2016</p>

Key issues and recommendations (cont.)

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

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

We will formally follow up these recommendations next year.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
2	3	<p>Review of Reconciliations</p> <p>There is a lack of formal evidence of review following the council's transition to being paperless. In some cases, it is possible to follow comments and to assess whether the reconciliations have been adequately prepared. However, staff with access to the saved locations could amend such comments.</p> <p>Furthermore, in the case of some of the prepared reconciliations, it is harder to judge management's awareness of the items contained therein. The monthly purchasing and creditors reconciliations are generated and produced, but with the absence of comments. As a result it is hard to assess whether management is content for reconciling items to be left until the next month or whether further investigation is required. Equally, while commentary is evident on bank reconciliations, part of the reconciliation to the bank balance is categorised by 'unmatched' items next to which no further commentary is provided.</p> <p>Recommendation</p> <p>Explore the possibility of implementing digital signatures. Assessing which reconciliations should be signed off is a matter of judgement and practicality. In particular, we recommend signing the monthly bank reconciliations, as this adds a layer of accountability and traceability against the risk of material fraud.</p> <p>Introduce further commentary and/or monitoring of the level of 'unmatched' items in each month's reconciliation to address the points above.</p>	<p>Agreed.</p> <p>The Finance Community of Practice team and the Case Management (Support Services) team will look to introduce electronic digital signatures and document procedures for commentary to be added to reconciliations. The monthly bank reconciliations will be signed and evidenced as such, with commentary on the 'unmatched' items.</p> <p>There have been issues with the reports for the monthly purchasing and creditors reconciliations which the Lead for Case Management (Support Services) has been in regular discussion with the software supplier about. This has now been resolved.</p> <p>The Deputy S151 Officer will also attend the monthly reconciliations meetings with the Case Management (Support Services) team to discuss any issues with implementing the above and to ensure that all of the external audit points are addressed and best practice followed.</p> <p>Responsible Officer</p> <p>Deputy S151 Officer in consultation with the Lead for Case Management (Support Services)</p> <p>Implementation Deadline</p> <p>September 2016</p>

Appendix 1

Key issues and recommendations

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

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

We will formally follow up these recommendations next year.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
3	3	<p>Payroll and HR Documentation</p> <p>We reviewed the process for new joiners and leavers in the year. In most cases, sufficient documentation was available and payroll cut-off was appropriate. We noted two of the leavers sampled lacked leaver forms, and we are also awaiting documentation on two further items.</p> <p>While we did not identify issues in terms of the checking and processing of payroll runs, we noticed that the monthly payroll reconciliations to the ledger were not up-to-date in South Hams at the time of our interim visit. There is a risk that any incorrect payments or differences could go unchecked.</p> <p>Recommendation</p> <p>Implement the policy to ensure that all the documents and forms required to meet HR's procedures are obtained. Payment runs should be reconciled to the ledger on a timely basis.</p>	<p>Agreed.</p> <p>The Finance Community of Practice team and the Case Management (Support Services) team will look to ensure that reconciliations are completed for payment runs on a timely basis. A reminder will be issued to managers regarding the importance of ensuring the correct paperwork is provided.</p> <p>Responsible Officer</p> <p>Deputy S151 Officer in consultation with the Lead for Case Management (Support Services)</p> <p>Implementation Deadline</p> <p>September 2016</p>



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