External audit report 2016/17

Dorset County Council

–

July 2017

Summary for Audit and Governance Committee

Financial statements

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

This report focusses on our on-site work which was completed in June 2017 on the Authority's significant risk areas, as well as other areas of your financial statements. Our findings are summarised on pages 4 – 5.

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.

We also anticipate issuing an unqualified audit opinion in relation to the Pension Fund's financial statements by 30 September 2017.

There were 4 audit adjustments identified as a result of our audit work related to disclosure requirements. These are detailed in Appendix 3.

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

We are now in the completion stage of the audit and anticipate issuing our completion certificate and Annual Audit letter on 24 July 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 has taken properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

We therefore anticipate issuing an unqualified value for money opinion.

See further details on page 16**.**

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 Governance Committee to note this report.

The key contacts in relation to our audit are:

Darren Gilbert
Director
KPMG LLP (UK)

+44 (0)292 046 8205
Darren.gilbert@kpmg.co.uk

John Oldroyd
Senior manager
KPMG LLP (UK)

+44 (0)238 020 2055
John.oldroyd@kpmg.co.uk

David Parson
Manager
KPMG LLP (UK)

+44 (0)238 020 2054
David.parson@kpmg.co.uk

Contents

Section one

Financial Statements

We anticipate issuing an unqualified audit opinion on the Authority's 2016/17 financial statements and the Pension Fund by 24 July 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 a deficit on the provision of services of £31.3m. The adjustments which are then required to present this accounting result in terms of the impact on the County Council's General Fund cause a decrease in the balance on that fund of £2.3m. The Authority has used £1.5m of capital receipts against its revenue expenditure in line with changes to restrictions on capital receipts announced by the Chancellor as a part of the Autumn 2015 Statement.

Significant audit risks

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

Significant audit risks	Work performed
1. Significant changes in the pension liability due to LGPS Triennial Valuation (Authority and Pension Fund)	**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 Dorset 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. We have also substantively agreed the total figures submitted to the actuary to the general ledger with no issues noted. We critically assessed the assumptions used in the pension valuation at 31 March 2017 to determine whether they were appropriate. No significant issues were noted in respect to the assumptions used. See page 9 for our assessment on the assumptions used by the actuary in the IAS19 report.
2. Fair value of property at the balance sheet date	**Why is this a risk?** The CIPFA Code of Practice on Local Authority Accounting requires that property is re-valued with sufficient frequency to ensure that there is not a material difference between the fair value of the assets and their carrying value, and in any case at a frequency of at least every five years. Historically, Dorset County Council has performed annual revaluations on a representative sample of a tranche of 20% of the property assets per year. Taking these valuation movements into account, a desktop valuation was applied to the other 80% of property assets. The valuation was performed as at the start of each financial year by the internal valuations team. There is a risk therefore that movements in property values both during the year and since the last asset revaluation date could result in a misstatement in the value of Dorset County Council's property portfolio. **Our work to address this risk** As part of our audit work, we assessed the processes the Authority has in place for valuations and confirmed that these were appropriate and that the valuations of property assets were made using reasonable assumptions. This included assessing the Authority's consideration of property value movements between the date of property valuation and the balance sheet date and indicators if impairment of assets. We have also evaluated the expertise of the preparer of the valuation report to ensure that they are sufficiently skilled and appropriately qualified such that we can rely on them for the provision of audit evidence.

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.

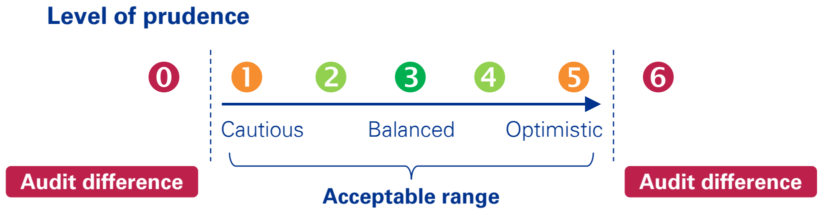
Other areas of audit focus

We identified two areas of audit focus. These are not considered as significant risks as there are less likely to give rise to a material error. Nonetheless these are areas 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	Our work to address the areas
1. Disclosures associated with retrospective restatement of CIES, EFA and MiRS	**Background** CIPFA has introduced changes to the 2016/17 Local Government Accounting Code (the Code): — Allowing local authorities to report on the same basis as they are organised by removing the requirement for the Service Reporting Code of Practice (SeRCOP) to be applied to the Comprehensive Income and Expenditure Statement (CIES); and — Introducing an Expenditure and Funding Analysis (EFA) which provides a direct reconciliation between the way local authorities are funded and prepare their budget and the CIES. This analysis is supported by a streamlined Movement in Reserves Statement (MiRS) and replaces the current segmental reporting note. The Authority was required to make a retrospective restatement of its CIES (cost of services) and the MiRS. New disclosure requirements and restatement of accounts require compliance with relevant guidance and correct application of applicable accounting standards. **What we have done** For the restatement, we obtained an understanding of the methodology used to prepare the revised statements and confirmed that it was in accordance with the accounting standards. We have also agreed figures disclosed to the Authority's general ledger and found no issues to note.
2. Preparation of group accounts	**Background** In 2015/16, Dorset County Council, along with Bournemouth Borough Council and Borough of Poole Council, formed Tricuro as a Local Authority Trading Company (LATC) to which they transferred their supplier-side Adults' Services. The parent company, Tricuro Support Ltd (TSL), is owned by the controlling authorities, and owns 100% of Tricuro Ltd (TL). From an accounting perspective, Dorset County Council and the other shareholder councils determined this LATC to be a joint venture in the form of a jointly controlled entity. As Dorset County Council's investment in the joint venture was considered to be material the Authority was therefore required under IFRS and the CIPFA Code to prepare group accounts to account for this under the accounting standards. In 2016/17, the Authority plans to consolidate other joint ventures and associates which had not previously been consolidated on the grounds of materiality, including SWAP (South West Audit Partnership) and TRICS. Dorset County Council's share of net assets and profits in these investments will therefore need to be accounted for in the consolidated group accounts, in line with IFRS and the CIPFA Code. **What we have done** We have reviewed the consolidation of the joint ventures and associates and confirmed that the treatment is in line with IFRS and the CIPFA Code.

Judgements

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



Subjective areas	2016/17	2015/16	Balance	Commentary
Provisions	3	3	CY: £2.6 million PY: £3.3 million	The provision balance is calculated on a consistent basis year on year and is deemed to be calculated on a reasonable basis
Deferred income	3	3	CY: £10.9 million PY: £10 million	We consider the related disclosures to be proportionate, and deferred income has been calculated on a consistent basis with the prior year.
PPE: Asset lives/ Valuation	3	3	CY: £391.8 million PY: £405.8 million	We have reviewed the valuation of PPE and the assumptions behind the valuation and the valuation basis appears reasonable.
Pensions	4	3	CY: £738.2 million PY: £639 million	We have reviewed the actuarial assumptions for the current financial year and noted the following; The discount rate used is considered less prudent than the KPMG expected assumption but consistent with the approach taken last year and within the acceptable tolerance range. This less prudent approach therefore places a lower value on liabilities. The Pension increases (CPI) assumptions are considered more prudent than our expected assumption, however the methodology is reasonable and consistent with prior year . The salary increase and mortality assumptions were both considered consistent and reasonable. Overall, the net discount rate (ie. the discount rate less CPI inflation) are within our tolerable range despite both individually being towards the extremes of our acceptable ranges. Therefore we consider the assumptions in combination to be reasonable.
Debtors Provisioning	3	3	CY: £1.4 million PY: £1.9 million	The Authority has calculated its debtors provision consistently year on year and it is deemed to be calculated on a reasonable basis.

Proposed opinion and audit differences

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 Governance Committee on 24 July 2017.

Audit differences

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

The final materiality level (see Appendix 4 for more information on materiality) for this year's audit was set at £10 million. Audit differences below £500,000 are not considered significant.

We did not identify any material misstatements, however we identified a small number of presentational and disclosure amendments required to ensure that the accounts are compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 ('the Code'). We understand that the Authority will be addressing these where significant.

Annual Governance statement

We have reviewed the Authority's 2016/17 Annual Governance Statement and confirmed that:

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

Narrative report

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

The report was well written and thoughtfully presented however it was highlighted that there were opportunities to be more explicit about the non financial performance in the year. Amendments were made to add detail to the final narrative provided.

The Pension Fund

We anticipate issuing an unqualified audit opinion on the Fund's 2016/17 financial statements following approval of the financial statements by the Audit and Governance Committee on 24 July 2017.

Pension fund audit

Our audit of the Fund also did not identify any material misstatements.

For the audit of the Fund we used a materiality level of £30 million. Audit differences below £1.5 million are not considered significant.

We did not identify any material misstatements, however we identified a small number of presentational and disclosure amendments required to ensure that the accounts are compliant with the Code. We understand that the Fund will be addressing these where significant.

Annual report

The Pension Fund Annual Report has not been prepared yet and we are yet to confirm that:

— It complies with the requirements of the Local Government Pension Scheme (Administration) Regulations 2008 [this is not part of our statutory responsibilities but may have been completed as added value work – delete if not done}; and

— The financial and non-financial information it contains is not inconsistent with the financial information contained in the audited financial statements.

The statutory deadline for publishing the document is 1 December 2017. The Pension Fund Annual Report is currently due to be approved by the Pension Fund Committee on 13 September 2017. We will need to complete additional work in respect of subsequent events to cover the period between signing our opinions on the Statement of Accounts and the Pension Fund Annual Report.

Accounts production and audit process

Our audit standards (*ISA 260*) require us to communicate our views on the significant qualitative aspects of the Authority's accounting practices and financial reporting.

We also assessed the Authority's process for preparing the accounts and its support for an efficient audit. The efficient production of the financial statements and good-quality working papers are critical to meeting the tighter deadlines.

SharePoint

We used SharePoint again this year, which is a cloud-based document storage system to facilitate the secure transfer of large amounts of data between the Authority and the audit team. This allows the Authority's finance team to efficiently share requested information.

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 good position to meet the new 2017/18 deadline.

We consider the Authority's accounting practices to be appropriate.

Completeness of draft accounts

We received a complete set of draft accounts on 18 May 2017, which is in line with our expectations for this year's audit.

Quality of supporting working papers

We issued our *Accounts Audit Protocol 2016/17* ("Prepared by Client" request) in December and May 2017 which outlines our documentation request. This helps the Authority and the Fund to provide audit evidence in line with our expectations. We also met with Management to discuss specific requirements of the document request list.

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

Response to audit queries

Officers dealt with our requests in a timely manner and were responsive to our queries which has enabled us to work together with the finance team to meet the shorter timescales for this year's audit.

Group audit

To gain assurance over the Authority's group accounts, we placed reliance on the work completed by the Tricuro audit team on the financial statements of the Authorities joint venture.

There are no specific matters to report pertaining to the group audit.

We are also pleased to report that there were no issues to note in relation to the consolidation process.

Pension Fund audit

The audit of the Fund was completed alongside the main audit. We have raised one recommendation in relation to notification of deferred members as outlined in more detail in appendix one.

Additional findings in relation to the Authority's control environment for key financial systems

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 of the recommendations in 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, we also tested the IT control environment around SAP. The strength of the control framework informs the substantive testing we complete during our final accounts visit. We have raised one recommendation in relation to SAP program changes as outlined in more detail in appendix one.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's 2016/17 financial statements.

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

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

Declaration of independence and objectivity

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

In relation to the audit of the financial statements of Dorset County Council and Dorset County Pension Fund for the year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and Dorset County Council and Dorset County Pension Fund, 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 Finance Manager for presentation to the Audit and Governance 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.).
- We received two elector letters requesting further information from previous freedom of information requests responses received from the Council. However it is not KPMG's responsibility to respond to such requests therefore these have been forwarded to management.

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority's 2016/17 financial statements.

Value for money

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

We have concluded that the Authority has made proper arrangements to ensure it took properly-informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

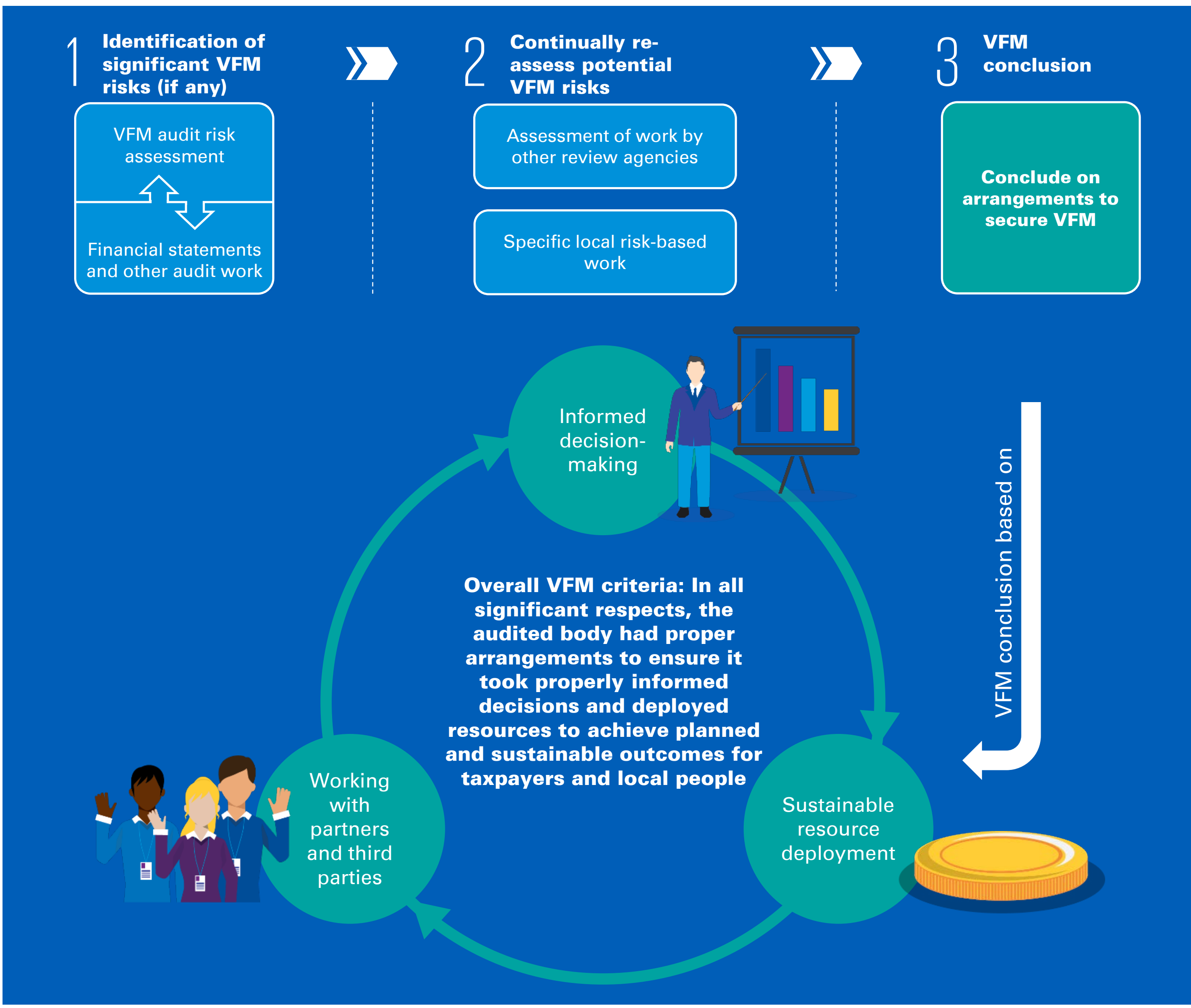
VFM conclusion

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to cause the auditor to reach an inappropriate conclusion on the audited body's arrangements.'

Our VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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



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
1. Ability of the council to meet savings targets	✓	✓	✓
2. 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 and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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

Significant VFM risks

We have identified two significant VFM audit risks as communicated to you in our *2016/17 External Audit Plan*. We are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas identified are adequate.

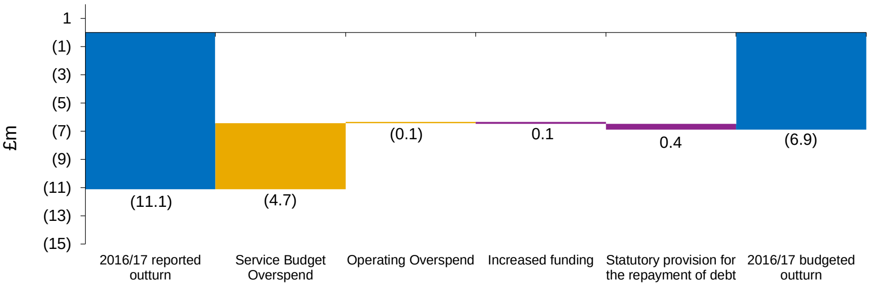
Significant VFM risks	Work performed
1. Ability of the council to continue to meet savings targets	**Why is this a risk?** Like most of local government, the Authority faces a challenging future driven by funding reductions and an increase in demand for services. Due to these pressures on local authorities, extensive cost cutting measures have been implemented to allow the Council to operate within its means. The council has been successful in the past at making these targeted savings, however the risk identified relates to the ability of the Council to continue to meet these cumulative cost cutting pressures. **Summary of our work** Discussions were held with key finance staff in order to develop out understanding of the processes and methods in place for producing budgets going forward and identifying areas of potential cost cutting. KPMG then reviewed the methods for identification of savings targets and actions plans in place to achieve these targets, as well as the ongoing monitoring of performance at a department and cabinet level. The Authority reported a £31m net deficit for 2016/17, with £2.3m funded out of general reserves and £8.7m funded out of the schools general reserves. The forward together plan has targeted savings of £18.3m in order to close the identified funding gap in 2017/18.

Funding bridge 2017/18

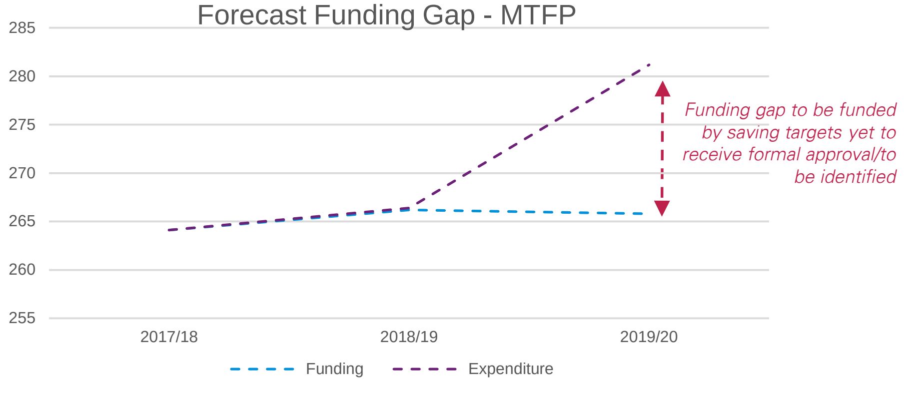
Significant VFM risks	Work performed
	(continued)

The Authority's MTFP details a balanced budget for 2017/18 including the forward together savings which have been identified. However, the MTFP details the increasingly difficult financial challenges faced each year, resulting in the need for ever rising savings which have yet to be identified, up to £49.4 million by 2019/20.

Outturn vs Budget 2016/17



We have carried out reviews and discussions with key personnel over the identified savings. The Council is aware of the savings required over the next few years and has identified the targeted savings required to break even over the next two years.



Currently, the Authority is awaiting further news from the Secretary of State for approval of the formation of a Unitary Council which would help achieve greater synergies going forward. There are also opportunities for increased funding once guidance for additional adult social care funding has been received, which has not been included in the MTFP above.

As a part of the audit work undertaken the process behind the annual budgets and mid-term plan were reviewed and steps taken to identify savings areas were discussed with finance personnel. Overall, despite the significant financial challenges facing the Authority, there are appropriate arrangements in place to ensure it takes properly informed decisions in relation to identifying future savings and planning for changes in funding arrangements.

Significant VFM risks	Work performed
2. Children's Services	**Why is this a risk?** There were several factors highlighted from our Value for Money risk assessment work which identified Children's services as a potential risk area *Overspend* In the current year there was an overspend of £6.1m. These were driven by several areas within the division; ▪ Quantity and Mix of services required – the past few years have seen an increase in both numbers of children and a shift in the level of services required to the more expensive means of support. ▪ SEN Transport being under budgeted – Due to errors in the prior year budget setting process where not all costs had come through when the year to date costs were reviewed. ▪ Agency staff costs – due to staff absences and shortages in workers. *Additional future saving plans* Given that the current year budget was exceeded, the 2017/18 budget is set with the 2016/17 budget as a baseline and a further £4.1m of savings have been identified by the Forward Together Plan, the ability of the council to meet these savings targets was considered to be a risk area. These savings need to be made on top of the overspend in the prior year as the prior year budget is used as a baseline measure. *Quality* A review of recent Ofsted reports as well as discussions with key personnel identified that there were potential quality improvements required. The underperformance coupled with the overspend and future additional savings planned highlighted a value for money audit risk. **Summary of our work** Discussions were held with the Children's Services manager over the issues encountered by the department including both the quality aspects and financial issues leading to overspends. Action plans in place to overcome the overspend and to improve quality of service were obtain to confirm that the Council has recognised these issues and plans are in place for the service to operate within budget and provide a suitable quality of service. The Authority had identified the areas of overspend and have come up with plans to address these areas. Overall, the council has reasonable arrangements in place to ensure it takes properly informed decisions over the actions required to deliver on both cost saving measures and quality improvement plans.

Appendices

Appendix 1

Key issues and recommendations

Our audit work on the Authority's 2016/17 financial statements has identified a number of issues. We have listed these issues in this appendix together with our recommendation which we have agreed with Management. We have also included Management's responses to this recommendation.

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

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

High priority — Issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.

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

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

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

2016/17 recommendations summary	
Priority	**Total raised for 2016/17**
High	-
Medium	1
Low	1
Total	2

Medium priority

1. Program changes

We noted as part of our review of the SAP controls that currently program change owners are also able to request process changes and therefore that there is not an appropriate level of segregation of duties.

There is a risk that program changes are not being appropriately monitored and managed to ensure that they are subject to the required level of testing and peer review prior to being implemented.

Recommendation

SAP program change owners (those who raise transport requests in the development environment) should be separate from program change users (those who migrate the change) for all program changes, and all program changes should be appropriately approved, tested, and signed off for implementation.

Management Response

Ordinarily, we believe our segregation of duty is sufficient as our process dictates that only the BASIS team members are able to move transports for the rest of the team into the Production environment. In the examples attached, the ADM_VINCENTM user transported their own changes during a small window only, as we had just put the DES upgrade live and so we were in a post implementation phase, meaning we had to be more reactive with changes while we were stabilising the system.

The ADM_PAIGEK transports relate to reporting changes only, so do not directly impact the system data or transactional functionality, they are simply additions or amendments to reporting formats that are available in the system, so feel this is very low risk.

Owner

Glen Conroy

Pension Fund: Key issues and recommendations

Low priority

2. Notification of deferred members

When testing controls over the membership data in Altair, we noted that the pension fund is reliant upon receiving the notice of termination in a timely manner from the payroll department of the admitted body. Our sample testing identified that a notice of termination form was not always received and so the system was not updated until the pensions team carried out the year end check, to ensure that all deferred members have been removed from their system.

Recommendation

We understand that the pension fund will be moving to a new process whereby employers submit electronic returns on a monthly basis. We recommend that the pension fund specifically request that admitted bodies flag any changes in membership as part of this process to ensure that new starters and leavers are identified on a timely basis.

Management Response

Accepted. We will review membership numbers on a more frequent basis throughout the year.

Owner

Karen Gibson

Deadline

31 March 2018

Appendix 2

Follow-up of prior year recommendations

In the previous year, we raised two recommendations which we reported in our *External Audit Report 2015/16 (ISA 260)*. The Authority has implemented all of the recommendations. We re-iterate the importance of the outstanding recommendations and recommend that these are implemented by the Authority.

We have used the same rating system as explained in Appendix 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	-	-	-
Mediu m	1	1	-
Low	1	1	-
Total	**2**	**2**	-

Low priority

1. Review of bank reconciliations

We noted that in some cases bank reconciliations were not reviewed until the month after they had been completed. There is a risk that errors are not identified on a timely basis and that reconciling bank items are not cleared on a timely basis.

Recommendation

It is recommended that The Authority ensures that the review of bank reconciliations is performed promptly to avoid errors and to ensure that outstanding items are cleared on a timely basis.

Management original response

Agreed. All bank reconciliations are up to date and authorised. There is now more resilience in the authorisation process as more staff are involved.

Owner

Sarah Baker

Original deadline

Implemented in 2015/16.

KPMG's June 2017 assessment

Fully implemented

Medium priority

2. PO and GRN prior to invoice date

We noted as part of work on accounts payable data analytics that there were 12,614 cases where a PO was dated after the invoice date and 441 cases where a GRN was dated prior to the PO date. This therefore indicates that goods and services are being ordered/arranged prior to going through the appropriate authorisation process.

Recommendation

It is recommended that training should be provided and staff should be reminded of the importance of obtaining authorisation prior to procuring goods and services.

Management original response

The current procure-to-pay review will pick up these concerns and develop a model which best fits the need for authorisation and recording of commitments as well as reducing process burden on the business.

Owner

Sarah Baker

Original deadline

To be implemented in 2016/17.

KPMG's June 2017 assessment

Fully implemented

Dorset County Council: adjusted audit differences

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

Financial Statement Disclosure	Adjustment Made
Cashflow Statement	Reclassification of £35,000,000 from short term borrowing repaid to new short term borrowing. £nil net effect on the cashflow statement.
Minimum Lease Receipts disclosure	Decrease of minimum lease receipts disclosure by £1,373,000 to £21,087,000. Disclosure only.
Pension employer contributions disclosure	Increase by £784,000 to £23,600,000. Disclosure only.
Classification of overdraft as cash and cash equivalents	The CIPFA Code says bank overdrafts are shown separately as liabilities in the Balance Sheet only where they are not an integral part of an authority's cash management. Therefore the overdrawn facilities have been reclassified in the current year (decrease in current assets by £12,255,000) and prior year (decrease in current liabilities by £19,201,000) to reflect this. No impact on net assets.
Fixed Asset Note	Reclassification of £1,878,000 of additions incorrectly netted off against disposals. £nil net effect on the financial statements.

Pension Fund: adjusted audit differences

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

Financial Statement Disclosure	Adjustment Made
Net Assets Statement and associated note	£42.7m of UK equities was incorrectly classified within the Overseas Equities balance. This has now been corrected in the Net Assets Statement and Note 11 to be classified within UK investments.

Appendix 4

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 March 2017.

Materiality for the Authority's accounts was set at £10 million which equates to around 1.8 percent of budgeted gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit and Governance 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 Governance 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 £0.5 million for the Authority.

Where management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit Committee to assist it in fulfilling its governance responsibilities.

Materiality – Pension fund audit

The same principles apply in setting materiality for the Pension Fund audit. Materiality for the Pension Fund was set at £30 million which is approximately 1.1 percent of gross assets.

We design our procedures to detect errors at a lower level of precision, set at £1.5 million for 2016/17

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 Governance Committee.

Ethical Standards require us to communicate to those charged with governance in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on our independence and the objectivity of the Engagement Lead and the audit team.

General procedures to safeguard independence and objectivity

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

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

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

Auditor declaration

In relation to the audit of the financial statements of Dorset County Council and Dorset County Pension Fund for the financial year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and Dorset County Council and Dorset County Pension Fund, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Appendix 5

Non-audit work and independence

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

Independence breach

In March 2008 and March 2010, the KPMG EU Funds Tax team entered into an agreement to provide tax services relating to the recovery of tax credits on foreign income dividends and overseas dividends and recovery of withholding tax on manufactured overseas dividends respectively to Dorset County Pension Fund. These engagements were on a contingent fee basis and at that time contingent fees on such services for audit clients were permitted.

In late 2010 the UK APB Ethical Standards for Non-Audit Services were revised, significantly restricting the ability for audit firms to deliver tax services to their UK audit clients on a contingent fee basis where the uncertainty surrounding the claim related to tax law which was uncertain or had not been established. Grandfathering provisions allowed existing contingent fee engagements entered into before 31 December 2010 with existing UK audit clients to continue unaffected until 31 December 2014. By that point in time the regulator (the APB) expected the services to be delivered and the fees settled.

From 1 January 2015 the services would not have been permissible under Para 95 of the APB’s Ethical Standard which prohibited contingent fee based tax engagements where the tax matter was uncertain or unestablished. This prohibition remains under the current FRC Revised Ethical Standard although the wording differs slightly.

Given the timeframe this matter has been under discussion with HM Revenue & Customs (‘HMRC’), we consider that this factor alone would, to a third party, be indicative of a tax matter which was contentious in nature and would be likely to be viewed as ‘uncertain or unestablished’ and we have treated this as such. Consequently, the contingent fee arrangements for recovery of tax credits on foreign income dividends and overseas dividends and recovery of withholding tax on manufactured overseas dividends are not permissible for audit clients and as a result the continuation of this contingent fee arrangement is a breach of our firm’s independence. In late 2014 we should have identified this service and either brought the engagement to a close or replaced the fee arrangement with an alternative time and materials fee basis to ensure compliance with the UK Ethical Standards by 1 January 2015.

We note that since September 2010 there had been no advice provided by KPMG as Pinsent Masons have been pursuing these claims through the Courts under a direct engagement. No further fees have been raised for the work since the initial work was completed in 2008 and 2010 (and the corresponding fees were raised in September 2008 and 2010 respectively).

We have considered the facts and do not believe the breach to be significant in terms of our overall consideration of independence and objectivity as your auditor. The factors we have taken into account include:

- The audit team were not aware of the existence of the service until April 2017 and as a result this would not have impaired their objectivity for the audit periods up to 31 March 2016.

- No fees in relation to this tax engagement have been billed to Dorset County Pension Fund since the change (effective from 1 January 2015) to UK APB Ethical Standards for Non-Audit Services were revised significantly restricting the ability for audit firms to deliver tax services to their UK audit clients on a contingent fee basis.
- The amount of the tax repayments under dispute the level of fees would not be material to either party.

- At no point would the outcome of the tax matters under dispute have been material to the financial statements. In addition as the matter is still unsettled the potential tax repayment has not been recognised in the accounts of the pension fund.

Based on the above, in our professional judgement, we have concluded that our objectivity as auditor has not been compromised and the firm and the engagement team maintained their independence of Dorset County Pension Fund. Finally, we can confirm that we have now terminated these engagements with immediate effect. We have also formally notified Public Sector Audit Appointments Limited of this matter.

Audit fees

Audit fees

As communicated to you in our External Audit Plan 2016/17, our scale fee for the audit is £74,022 plus VAT *(£74,022 in 2016/17)*. Our scale fee for the audit of the pension fund is £25,146 plus VAT *(£25,146 in 2016/17)*.

PSAA fee table		
Component of audit	**2016/17** *(planned fee)* £	**2015/16** *(actual fee)* £
Accounts opinion and use of resources work		
PSAA scale fee	74,022	74,022
Pension Fund audit	25,146	25,146
Total fee for the Authority set by the PSAA	**99,168**	**99,168**

All fees are quoted exclusive of VAT.

As in previous years, we have been requested to carry out additional work on the Pension Fund by the auditors of Dorset Fire Authority, the Crime Commissioner for Dorset and Chief Constable of Dorset Police, Bournemouth Borough Council, Borough of Poole, Christchurch Borough Council, East Dorset District Council, North Dorset District Council and Purbeck District Council. The Pension Fund is able to recharge these costs back to the admitted bodies. Our fee for this additional work is £2,227 and is subject to approval by Public Sector Audit Appointments Ltd.