Agenda Item No: 6

External Audit Plan 2017/18

LGSS

March 2018

Headlines

Financial statement audit

LGSS does not have a statutory responsibility to produce Financial Statements for the year ending 31 March 2018. Our Financial Statements audit is therefore being completed as a 'non-statutory' audit of a set of non-statutory Statement of Accounts, prepared under the CIPFA Code of Practice, agreed in our Engagement Letter with LGSS.

Materiality

Materiality for planning purposes has been set at £1,175,000 which equates to 1.5% percent of the gross expenditure from 2016/17.

We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance and this has been set at **£59,000**.

Significant risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error have been identified as:

- Fraud risk of revenue recognition; and
- Management override of controls.

Other areas of audit focus

The risk with less likelihood of giving rise to a material error but which is nevertheless worthy of audit understanding have been identified as the future operating model and system change from Oracle to Agresso.

Logistics

Our team remains unchanged from last year and consists of:

- Andrew Cardoza – Director
- Daniel Hayward – Senior Manager
- Harry Organ – Assistant Manager
- Laura Tilley – In Charge Auditor

More details are on **page 10**.

Our work will be completed in four phases from December 2017 to September 2018 and our key deliverables are this Audit Plan and a Report to Those Charged with Governance as outlined on **page 9**.

Our fee for the audit is £24,500 excluding outlays and VAT (£22,450 in 2016/17, including £11,300 of additional audit fees) see **page 8** for more details**.**

Introduction

Background and Statutory responsibilities

This document supplements our Engagement Letter, issued by ourselves to LGSS and signed on behalf of LGSS, and then subsequently re-issued in February 2018. It describes how we will deliver our financial statements audit work for the LGSS Joint Committee ("LGSS"). We are required to satisfy ourselves that your accounts comply with statutory requirements and that proper practices have been observed in compiling them. We use a risk based audit approach.

The audit planning process and risk assessment is an on-going process and the assessment and fees in this plan will be kept under review and updated if necessary.

The main purpose of our audit, which is carried out in accordance with International Standards on Auditing (ISAs) issued by the Auditing Practices Board, is to issue a report to LGSS that expresses our opinion on whether the financial statements give a true and fair view and have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.

Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

The audit planning process and risk assessment is an on-going process. The assessment and fees in this plan will be kept under review in the coming months and updated if necessary. We will have particular regard to the recent Best Value Inspection for Northamptonshire County Council and the comments made on LGSS. We have identified a specific area of audit focus relating to the future operating model assessment (see **page 6**) however we will continue to assess the impact of the Inspection by performing enquiries with management. Any change to our identified risks and audit procedures will be reported to the Joint Committee.

Financial statements process

For financial year ended 31 March 2018 Local Authorities are required to publish draft accounts by 31 May 2018 and audited accounts by 31 July 2018. LGSS choose to produce a 'non-statutory' Statement of Accounts therefore the faster closedown deadlines do not apply to the LGSS Statement of Accounts.

Management has elected that the audited Statement of Accounts will be published at the September 2018 LGSS Joint Committee for sign off. This would represent a brought forward timeframe compared to the 2016/17 audit, with the accounts being published at the December 2017 Joint Committee.

Financial Statements Audit

Our financial statements audit work follows a four stage audit process which is identified below. Appendix 1 provides more detail on the activities that this includes. This report concentrates on the Financial Statements Audit Planning stage of the Audit.

Financial statements audit planning	**Substantive procedures- interim**	**Substantive procedures- final**	**Completion**

Acknowledgements

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

Financial statements audit planning

Financial Statements Audit Planning

Our planning work involves the following key aspects:

— Risk assessment;

— Determining our materiality level; and

— Issuing this audit plan to communicate our audit strategy.

The diagram opposite identifies significant risks and other areas of audit focus, which we expand on overleaf. The diagram also identifies a range of other areas considered by our audit approach.

Risk assessment

Professional standards require us to consider two standard risks for all organisations:

Management override of controls – Management is typically in a powerful position to perpetrate fraud owing to 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. In line with our methodology, we carry 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.

Fraudulent revenue recognition – As with management override of control, this is a specific risk which we are required to consider by professional standards. Due to the nature of the LGSS operating model where income is recognised from customers and Host Authorities we have identified this risk. We have outline the risk in more detail and our audit testing approach on page 5.

Significant risks

Professional standards require us to consider two standard risks for all organisations. We are not elaborating on these standard risks in this plan but consider them as a matter of course in our audit and will include any findings arising from our work in our ISA 260 Report.

Fraud risk of revenue recognition

Risk

Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.

The core source of income for LGSS is budget allocations between the host authorities and LGSS. The recharges involved in this allocation can result in management judgement in allocating revenue correctly. This creates an opportunity for fraudulent recognition of revenue.

LGSS also receive revenue from external customers via a Service Level Agreement with stated contract values. Some contracts have elements which are based on activity which creates a higher risk of manipulation.

Our audit work

We will test the existence and accuracy of income recognised in the year. We will focus our testing on the key income streams including non-contracted income and recharges. This will include a review and challenge of income calculations as appropriate and agreement to cash receipts where appropriate. Our audit team will remain alert to indications of fraud during the course of the audit, and will respond accordingly.

Management override of controls

Risk

Professional standards require us to communicate the fraud risk from management override of controls as significant.

Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

We have not identified any specific additional risks of management override relating to this audit.

Our audit work

Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we will test the operating effectiveness of controls over journal entries and post closing adjustments.

We will also assess the appropriateness of changes compared to the prior year to the methods and underlying assumptions used to prepare accounting estimates.

We will also review the appropriateness of the accounting for significant transactions that are outside the component's normal course of business, or are otherwise unusual.

Other areas of audit focus

Those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding.

LGSS Operating model

Risk

On 15 March 2018 the Ministry of Housing, Communities and Local Government published a Best Value Report on Northamptonshire County Council, one of the LGSS host authorities. The report noted a number of findings with regard to the Northamptonshire's relationship with LGSS.

Our responsibilities as the non-statutory Auditors of LGSS include obtaining an understanding of LGSS management's response to the findings of the report and action undertaken in respect of these findings. We will then use this work to underpin any additional procedures required over changes undertaken by the new Managing Director and wider LGSS management. This will include review of any changes to the LGSS operating model. This work will then complement our required work over management's future operating model assessment.

Our audit work

We will meet with the LGSS Managing Director and management team to understand the response to the report and any changes made. We will review any changes to the operating model for impact on the 31 March 2018 Statement of Accounts, up to the point of signing our Audit Report.

We will obtain and review management's assessment and response for LGSS. To support this review of changes to the operating model and Management's ongoing and future assessment we will:

- Review of budgetary reports issues to the Joint Committee;
- Review minutes from Joint Committee meetings; and
- Assess minutes of the Host Authority Cabinets and Committees where items applicable to LGSS are discussed.

Implementation of Agresso ERP Gold system

Risk

From 1 April 2018 the host Authorities will transfer their financial systems from Oracle to Agresso. The LGSS financial system is held on that of the host Authorities, therefore will also be transferred. Although this will not impact the 2017/18 financial statements there is risk to future financial reporting, in particular in relation to the migration of data from Oracle to Agresso. Notwithstanding the potential benefits that this new system may deliver to the host Authorities we have identified this as an other area of audit focus for 2017/18 as we would be required to undertake our final audit work following the system change.

Our audit work

We will review the delivery arrangements that are in place for LGSS over the system transfer and assess the likely impact on the 2017/18 audit. We will use this to inform our testing of the completeness and accuracy of the general ledger transfer to Agresso for 2018/19.

Financial statements audit planning (cont.)

Materiality

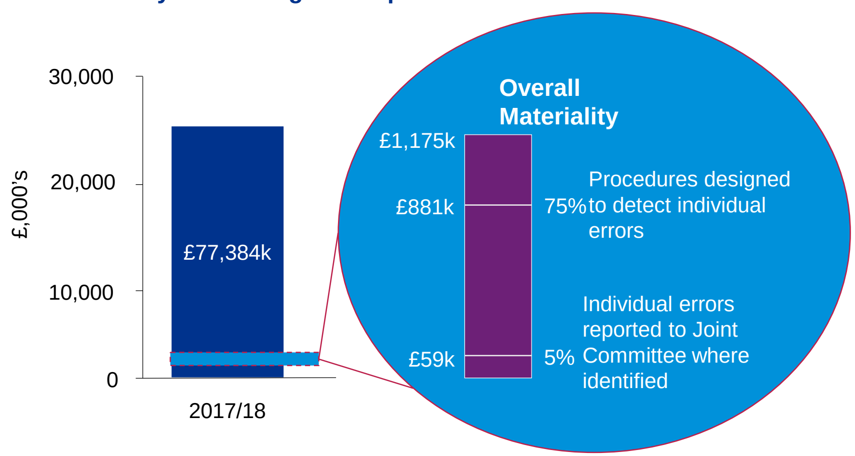
We are required to plan our audit to determine with reasonable confidence whether or not the financial statements are free from material misstatement. An omission or misstatement is regarded as material if it would reasonably influence the user of financial statements. This therefore involves an assessment of the qualitative and quantitative nature of omissions and misstatements.

Generally, we would not consider differences in opinion in respect of areas of judgement to represent 'misstatements' unless the application of that judgement results in a financial amount falling outside of a range which we consider to be acceptable.

Materiality for planning purposes has been set at £1,175,000 which equates to 1.5% percent of the gross expenditure from 2016/17. This is an increase from 1% in 2016/17 which equated to a materiality of £775,000. The primary reason for this increase is that Milton Keynes Council has now been fully incorporated into LGSS therefore the associated risk with incorporating a third partner have decreased.

We design our procedures to detect errors in specific accounts at a lower level of precision.

LGSS materiality based on gross expenditure 2016/17



Reporting to the Joint 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 Joint Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work.

Under ISA 260 (UK&I) 'Communication with those charged with governance', we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK&I) defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

In the context of LGSS, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £59,000.

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

Other matters

Our audit team

Our audit team will be led by Andrew Cardoza as your engagement Director. Andrew will be supported by Daniel Hayward, Harry Organ and Laura Tilley who have previously been part of the LGSS audit team. This will allow us to undertake an efficient audit using our understanding of the LGSS financial reporting framework.

Appendix 2 provides more details on specific roles and contact details of the team.

Reporting and communication

Reporting is a key part of the audit process, not only in communicating the audit findings for the year, but also in ensuring the audit team are accountable to you in addressing the issues identified as part of the audit strategy. Throughout the year we will communicate with you through meetings with the Finance team and the LGSS Joint Committee. Our communication outputs are included in Appendix 1.

Independence and Objectivity

Auditors are also required to be independent and objective. Appendix 3 provides more details of our confirmation of independence and objectivity.

Audit fee

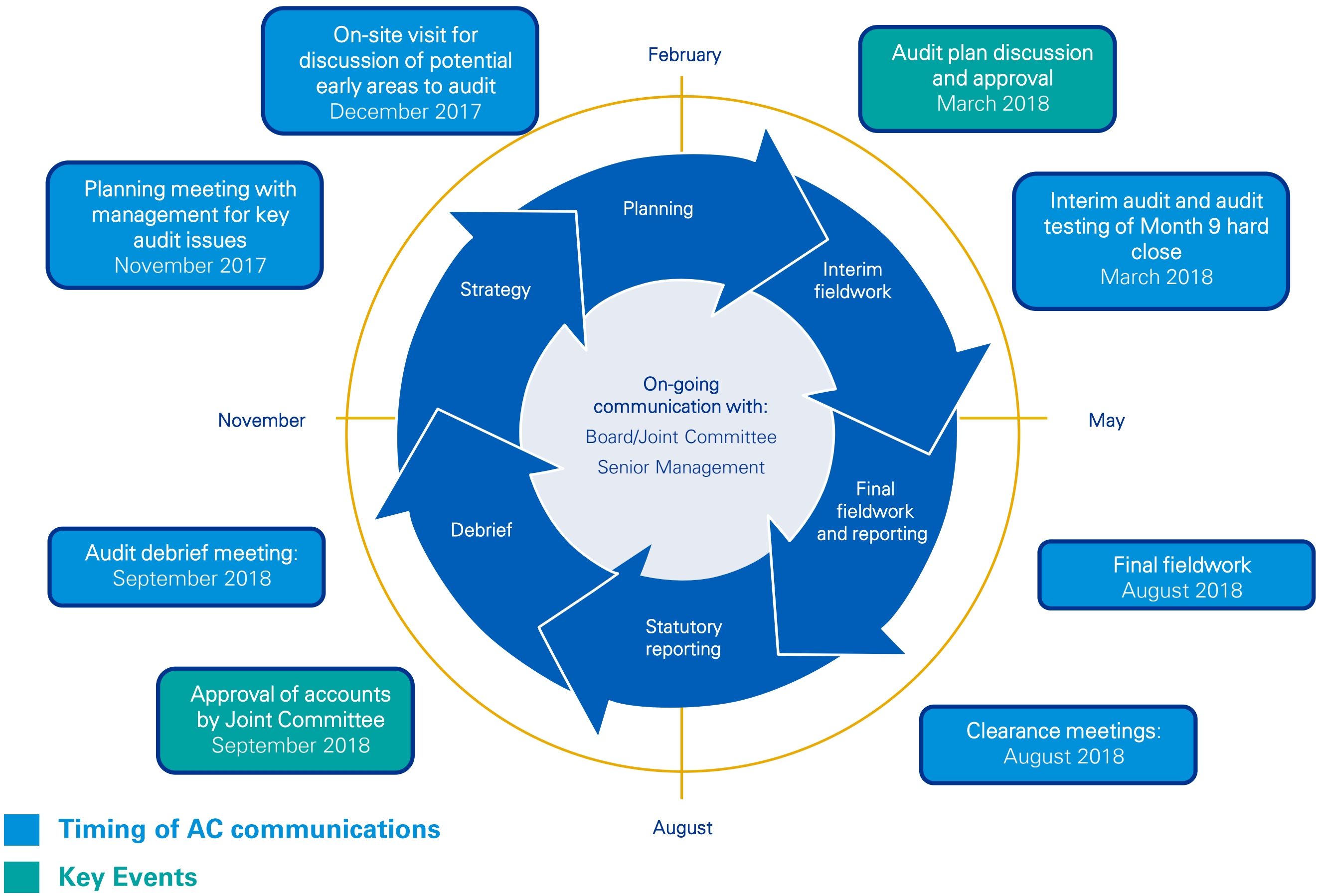
Our Engagement Letter presented to you in February 2018 first set out our fees for external audit services. This letter also sets out our assumptions. We have not considered it necessary to make any changes to the agreed fee at this stage.

The proposed audit fee for 2017/18 is £24,500. This reflects a standard audit approach and is exclusive of outlays and VAT.

Our base audit fee for 2016/17 was £22,450. As part of our audit we incurred additional time in respect of the incorporation of Milton Keynes and delays in audit evidence. This resulted in additional fee of £11,300 for the 2016/17 audit.

Our 2017/18 fee reflects an increase in our base fee due to the permanent increased scope in work which has resulted from the consolidation of Milton Keynes.

Appendix 1: Our schedule November 2017 - September 2018



Appendix 2: Audit team

Your audit team has been drawn from our specialist public sector assurance department. Our senior audit team has remained the same as last year, with some changes to the onsite delivery team in 2017/18.

Name	Andy Cardoza
Position	Director
	'My role is to lead our team and ensure the delivery of a high quality, value added external audit opinion. I will be the main point of contact for the Joint Committee and Managing Director.'

Andy Cardoza
Director
andrew.cardoza@kpmg.co.uk
+44 77 1186 9957

Name	Daniel Hayward
Position	Senior Manager
	'I am responsible for the management , review and delivery of the audit of LGSS. I will liaise with the Managing Director and Director of Finance'

Daniel Hayward
Senior Manager
daniel.hayward@kpmg.co.uk
+44 77 7610 1412

Name	Harry Organ
Position	Assistant Manager
	'I will be responsible for management, review and delivery of the audit work and lead the delivery of our work. I will liaise with the Director of Finance and the Closedown team to provide a smooth audit process.'

Harry Organ
Assistant Manager
harry.organ@kpmg.co.uk
+44 74 6836 9664

Name	Laura Tilley
Position	In-Charge Auditor
	'I will be responsible for the on-site delivery of our work and will supervise the work of our audit assistants.'

Laura Tilley
In-Charge Auditor
laura.tilley@kpmg.co.uk
+44 78 2688 4722

Appendix 3: Independence and objectivity requirements

To the members of the Joint Committee

Assessment of our objectivity and independence as auditor of LGSS.

Professional ethical standards require us to provide to you at the planning stage of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed.

This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

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 partners and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Communications
- Internal accountability
- Risk management
- Independent reviews.

The conclusion of the audit engagement lead as to our compliance with the FRC Ethical Standard in relation to this audit engagement and that the safeguards we have applied are appropriate and adequate is subject to review by an engagement quality control reviewer, who is a partner not otherwise involved in your affairs.

We are satisfied that our general procedures support our independence and objectivity.

Reliance on the work of external experts

We confirm that we may use work from external experts engaged by KPMG and will receive a confirmation from them regarding their independence before they assist in any work.

Confirmation of audit independence

We confirm that as of the date of this letter, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the associate partner and audit staff is not impaired.

This report is intended solely for the information of the Board of Directors and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

Yours faithfully

KPMG LLP

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