External audit report 2016/17

LGSS

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November 2017

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This document summarises the key findings in relation to our 2016-17 non-statutory external audit at LGSS.

This report focusses on our on-site work which was completed in September and October 2017 on LGSS's significant risk areas, as well as other areas of your financial statements. Our findings are summarised on pages 6-7.

We anticipate issuing an unqualified non-statutory audit opinion on LGSS's financial statements.

We have identified five audit adjustments with a total value of £5.5 million. See page 28 for details.

Based on our work, we have raised seven recommendations. This includes three high priority. Details on our recommendations can be found in Appendix 1.

We are now in the completion stage of the audit and expect to issue our opinion following the approval of the Statement of Accounts by the Joint Committee on 24 August 2017 and the receipt of the LGSS management representation letter.

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 Joint Committee to note this report.

Section one

Financial Statements

We anticipate issuing an unqualified audit opinion on the LGSS 2016/17 financial statements. 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, LGSS has reported a deficit on provision of services of £0.331m and usable reserves of £1.694m.

Significant audit risks

Our *External Audit Plan 2016/17* set out our assessment of LGSS'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. Incorporation of Milton Keynes Council	**Why is this a risk?** From 1st April 2016 Milton Keynes Council was added as a third partner within LGSS and member of the LGSS Joint Committee. Milton Keynes Council will therefore provide additional budget to LGSS and these transactions will be recognised on the Milton Keynes Council general ledger. Milton Keynes Council uses SAP for their general ledger, different to the Oracle general ledger system used by both Cambridgeshire County Council and Northamptonshire County Council. This will create a more complex accounts production process for LGSS that will need to incorporate all transactions completed on the Milton Keynes Council ledger. There is therefore a risk that LGSS is not set up correctly on the Milton Keynes Council ledger and LGSS transactions for inclusion in the accounts are not complete or include transactions that do not relate to LGSS. **Our work to address this risk** As part of our audit we have held discussions with key Officers and assessed the approach to integrating LGSS transactions from the Milton Keynes Council ('MKC') general ledger as appropriate. We have reviewed the Closedown team's process and mapping of the MKC ledger to the LGSS Statement of Accounts, no significant issues were identified. We undertook substantive testing of LGSS transactions recognised in the MKC ledger. Our audit work identified one minor adjustment below our reporting threshold therefore no adjustment was proposed. However we have raised a recommendation to improve the process of integrating a Host Authority into LGSS, see recommendation seven.

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 LGSS as there is unlikely to be an incentive for management 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 they 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 (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. LGSS 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 have obtained an understanding of the methodology used to prepare the revised statements. We have also agreed figures disclosed to LGSS's general ledger and found no significant issues to note. We have verified that the directorates used in the LGSS CIES are consistent with their internal budget monitoring reporting.
2. System change from Oracle to Agresso	**Background** From 1 September 2017 LGSS will transfer its financial systems from Oracle to Agresso. Although this is happening during the 2017/18 financial year the preparation and project management occurs in 2016/17 and therefore we have identified this as an area of audit focus for 2016/17. Our audit work will focus on the governance and controls over the migration process that will then impact our 2017/18 audit opinion. **What we have done** Since our meeting with the NCC's System Change team on 1 February 2017, we understand that the migration date has been deferred. The migration is now expected to take place before the 2017 Christmas period. We worked with LGSS to agree a common approach between the different audit firms involved in the process. In July 2017, LGSS confirmed the joint audit approach. We are scheduled to begin this work closer to the go-live date of April 2017 and following completion of this year's audit. Based on our work and discussions with LGSS, we understand that there is no audit impact for the 2016/17 financial statements. Nonetheless this remains a future risk for LGSS, and we will continue our on-going work with LGSS to gain assurance over the migration process.

Proposed opinion and audit differences

We anticipate issuing an unqualified audit opinion on LGSS's 2016/17 financial statements following approval of the Statement of Accounts by the Joint Committee on 24 November 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 for this year's audit was set at £775,000, see Appendix 4 for more information on materiality. This is consistent with the materiality reported in our External Audit Plan in June 2017. Audit differences below £38,000 are not considered significant.

Our audit identified a total of four significant audit differences, which we set out in Appendix 3. Management have agreed to correct all audit differences identified.

In addition, we identified a number of presentational adjustments 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 LGSS will be addressing these where significant.

Annual Governance Statement

We have reviewed LGSS'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 LGSS's 2016/17 Narrative Report and have confirmed that it is not inconsistent with the financial statements and our understanding of LGSS.

Annual Report

We have reviewed LGSS's 2016/17 Annual Report and can confirm it is not inconsistent with the financial information contained in the audited financial statements.

Accounts production and audit process

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

We also assessed LGSS'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 crucial to a smooth audit process.

Introduction of KPMG Central

We introduced KPMG Central this year, which is a cloud-based document storage system to facilitate the secure transfer of large amounts of data between LGSS and the audit team. KPMG Central aligns to our Accounts Audit Protocol and allows LGSS's Closedown team to efficiently share requested information. Feedback from the Closedown team has been positive and it allows us to keep track of uploaded documents.

Completeness of draft accounts

We received an initial set of draft accounts on 31 July 2017 prior to commencing our on-site audit. We commenced our on-site work 14 August 2017 using the draft accounts provided. However, we did not receive supporting working papers from LGSS for the start our on-site work therefore were unable to start undertaking our audit procedures. We agreed with the Head of Integrated Closedown that it was appropriate to come off-site from the LGSS audit to allow management sufficient time to prepare our client working papers that would allow us to undertake our testing. This resulted in additional KPMG time to identify new team members to commence the audit under the revised timetable.

We flagged to management that it was crucial all working papers provided reconciled to the LGSS Statement of Accounts in order for us to complete our testing. We returned to LGSS to complete our audit work on 29 August 2017. However, the working papers had not been reconciled to the Statement of Accounts. The reconciliation identified a number of differences between the underlying working papers and the LGSS Statement of Accounts. This resulted in a number of changes to the draft accounts and we received a revised set of draft accounts on 30 August 2017.

Quality of supporting working papers

We had informed management in our planning discussions in May 2017 there were limited changes to the prior year *Accounts Audit Protocol*. We issued our final *Accounts Audit Protocol 2016/17* ("Prepared by Client" request) in August 2017 which outlined minor changes in addition to the prior year documentation requests. Our prepared by client request helps LGSS to provide audit evidence in line with our expectations. We followed this up with a meeting with Management on 10 August to discuss specific requirements of the document request list.

We requested that all Prepared by Client working papers are reconciled to each host authority ledger and also to the LGSS Statement of Accounts. This was not completed for key working papers including income, non-pay expenditure, payroll expenditure, debtors and creditors. The reconciliation completed by management resulted in a number of changes to the draft accounts resulting in a revised set of draft accounts being provided on 30 August 2017.

As part of moving the on-site work to start 29 August 2017 we requested the listings for income, non-pay expenditure, debtors and creditors were provided by 23 August 2017. This was to enable us to select our samples prior to be being on-site. However, the delay in receiving reconciled Prepared by Client working papers resulted in a delay in us selecting our samples. We were therefore unable to share our samples prior to being onsite. This resulted in delays as management compiled the sample requiring additional KPMG staff time in order to complete the testing.

The quality of audit evidence initially provided for sampled transactions did not align to our expectations for robust evidence. This caused additional delays and placed additional pressures on the audit resulting in further KPMG staff time in order to complete testing. There is an opportunity for improvements to be made in providing clear and concise audit trail of underlying transactions.

Accounting practices and financial reporting

LGSS does not have its own ledger and therefore the Statement of Accounts is created by combining the general ledgers of Northamptonshire County Council, Cambridgeshire County Council and Milton Keynes Council. This process resulted in us receiving corrected draft accounts to ensure they agreed to underlying records within the general ledgers. It also resulted in four audit differences as a result of this process.

In our view the current financial reporting process in place is not sufficiently robust for an organisation the size of LGSS. Management need to undertake a fundamental review of the LGSS financial reporting process in order to decrease the amount of resource required to produce the LGSS accounts and improve the quality to reduce the number of audit differences.

We have raised three recommendations in Appendix 1 to support LGSS to improve its financial reporting process.

1. General Ledger setup;
2. Recharges; and
3. Milton Keynes cost centres.

Each recommendation has been split between considerations for 2017/18 financial reporting on the current Oracle system and 2018/19 financial reporting on the new Agresso system.

LGSS is not required to meet the earlier closedown deadlines in 2017/18 due to producing non-statutory accounts. This provides management with flexibility in the timing of the LGSS accounts production and audit process against the demands on the Closedown team's time. We will actively engage with LGSS prior to the audit process in order to further support the closedown process.

Response to audit queries

There were a number of delays in receiving responses to audit queries raised over the course of the LGSS audit.

Evidence relating to some areas of sample testing took over four weeks to be provided, including items for payroll and LGSS Law. There were also delays in relation to sampled transactions selected from the Milton Keynes Council ('MKC') ledger for the following reasons:

- The Closedown team were unable to access the MKC SAP general ledger system; and
- Limited capacity in respect of the MKC Closedown team to address these queries.

Both issues caused delays in receiving all sample items back.

Prior year recommendations

As part of our audit we have specifically followed up LGSS's progress in addressing the recommendations in last year's ISA 260 report.

LGSS has implemented one of the recommendations in our 2015/16 ISA 260 Report with three recommendations not implemented or superseded by 2016/17 recommendations.

Appendix 2 provides further details.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of LGSS'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 LGSS for the year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and LGSS, 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 Director of Finance for presentation to the Joint 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 judgement, 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 (for example 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).

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 LGSS 2016/17 financial statements.

Appendices

Key issues and recommendations

Our audit work on LGSS's 2016/17 financial statements has identified seven issues. These issues have been split between LGSS Financial systems issues and LGSS control environment issues.

We have listed these issues in this appendix together with our recommendations which we have agreed with Management. We have also included Management's responses to these recommendations.

LGSS should closely monitor progress in addressing the risks, including the implementation of our recommendations. We will formally follow up these recommendations next year.

Each issue and recommendation have 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	Financial systems recommendations raised from our audit	Control environment recommendations raised from our audit	Total raised for 2016/17
High	2	1	**3**
Medium	-	2	**2**
Low	1	1	**2**
Total	**3**	**4**	**7**

Financial systems issues and recommendations

We have previously raised a recommendation over the LGSS financial systems in our 2015/16 *External Audit Report.* Our issues and recommendations are split into Financial systems issue and recommendations and general control environment recommendations.

High priority

1.General Ledger setup

Our audit testing identified four misstatements, reported in appendix three, through errors in the LGSS financial reporting process. These issues are due to the current financial reporting process where extracts from the Northamptonshire County Council, Cambridgeshire County Council and Milton Keynes Council general ledgers are combined to create the LGSS Statement of Accounts. We had previously raised a recommendation in our 2015/16 *External Audit Report* to highlight the challenges with the current LGSS financial reporting process. The implementation of this recommendation has been delayed due to the deferral of the Agresso system go live to 1 April 2018. Management will continue to use the current set up for the 2017/18 financial reporting process creating the following issues:

- Inclusion of subjective codes that are not related to LGSS;
- Inter-Host Authority transactions requiring manual netting off for example NCC and CCC matching debtors and creditor balances; and
- Income balances incorrectly included within expenditure and vice versa.

The above issues resulted in the financial reporting process for LGSS requiring additional closedown team resource, and increased the audit procedures required. Due to the potential for error within the financial reporting process we are required to perform additional procedures to gain appropriate and sufficient assurance over the accounts.

Recommendation

a. 2017/18 Oracle financial reporting

The 2017/18 financial reporting will continue to use the Oracle financial system. Therefore management need to complete a root and branch review of its process for creating the LGSS accounts. This should involve engagement of stakeholders and finance business partners who form part of the financial reporting process to identify methods of simplifying the accounts production and audit process.

In addition management should assess the Closedown team resource and resilience in creating the Statement of Accounts. This should supplement the audit readiness and timing recommendation detailed in recommendation 4.

(continued overleaf)

a. 2017/18 Oracle financial reporting

Management Response

It is agreed that the financial reporting process for LGSS has increased in complexity and also the volume of data required to compile the accounts. A review will be undertaken to identify improvements in the processes with the aspiration to simplify the arrangements where possible.

Management will implement recommendations 2 and 3 as detailed below.

However management is of the opinion that the approach to the audit also needs to be revisited and will be discussing this matter with KPMG ahead of the 2017/18 audit. The substantive approach to the audit sampling generated a huge volume of transactions (c400) for which evidence was required. This presented a significant challenge to turnaround within the audit timeframes.

In terms of the resources, the Integrated Closedown Team is lean and will be working to deliver the statutory accounts of the Partner authorities to earlier deadlines. Plans and approaches are being developed in this regard and the LGSS financial reporting will be considered as part of the planning for 2017/18.

Owner

Head of Integrated Finance

Deadline

31 January 2018

(continued)

Failing to implement improvements to the current process, prior to the implementation of Agresso, will result in continued high levels of Closedown team time to create the LGSS Statements of Accounts. It also results in a higher external audit fee due to the audit procedures required to verify the accounts production process.

b. 2018/19 Agresso financial reporting

As part the Agresso implementation LGSS should fundamentally review the current financial reporting set up within the three Host Authority general ledgers. This should include discontinuing the use of three ledgers with LGSS cost centres and replacing it with a standalone LGSS ledger in order to establish the autonomy of LGSS from the transactions from the Host Authority.

b. 2018/19 Agresso financial reporting

Management Response

Agreed, LGSS has started to develop a revised basis for the financial reporting of LGSS, which will be scalable for when additional partners join in the future. The proposed approach has been shared with the CFOs of the existing partners. It is still in development and is therefore not likely to be implemented until 2018/19 at the earliest after the ERP Gold solution has been implemented. Transitional arrangements are being considered for 1 April 2018.

Owner

Director of Finance

Deadline

31 March 2019

High priority

2. Recharges

Within LGSS there are a number of netting off balances. These arise when costs are recognised in one cost centre and then 'recharged' to different cost centres. For staff costs there are no issues as costs included are reconciled to those held within the payroll system. However this is an issue for non-pay expenditure and income.

Income

LGSS has three income streams firstly the base budget allocated by Host Authorities, external invoiced income and income with Host Authorities recognised with a journal. This is not an issue for the Host Authority base budget however occurs for both external invoice income and income that is journaled where there are a number of allocations.

Income summary			
	NCC ledger	CCC ledger	MKC ledger
Income initially recognised within the LGSS ledger	-36,403,326	-14,119,941	-5,564,044
Income subsequently removed from the LGSS ledger	9,169,427	898,340	2,771,857
LGSS actual income recognised	**-27,233,899**	**-13,221,601**	**-2,792,187**

The above reported total represents 58.1% of the LGSS Gross Income.

(continued overleaf)

a. 2017/18 Oracle financial reporting

Management Response

Agreed, management will determine a recharges approval process to be implemented. However given the timing of this audit report any revised arrangement will not cover the whole of the 2017/18 financial year.

An analysis of the recharges will be factored into the year end processes with a view to reduce the number of transactions for the accounts production and audit process.

Owner

Head of Integrated Finance and

Head of LGSS Business Planning and Finance

Deadline

31 March 2018

Non-pay expenditure

LGSS recognise non-pay expenditure from the accounts payable system at the Host Authority. However a number of costs are removed from the LGSS general ledger and allocated elsewhere within the Host Authority.

Summary of positive and negative items posted			
	NCC ledger	CCC ledger	MKC ledger
Non-pay expenditure initially recognised within the LGSS ledger	23,530,315	10,527,142	5,716,593
Non-pay expenditure subsequently removed from the LGSS ledger	-11,584,026	-3,876,784	-3,261,863
LGSS actual non-pay expenditure recognised	**11,946,289**	**6,650,358**	**2,454,730**

The value of the recharges means that establishing actual non-pay expenditure and income transactions that relate to LGSS, in order to undertake sample testing, is more challenging. This resulted in higher samples sizes with a number of transactions included within our sample that have a net impact of zero on the LGSS Statement of Accounts.

Furthermore, the recharge transactions to allocate costs and/or income are internally posted within the Host Authority ledgers therefore do not have the same controls as externally raised invoices. This creates a risk that transactions are inaccurately or inappropriately included within the LGSS ledger.

Recommendation

a. 2017/18 Oracle financial reporting

Management should implement a recharges approval process for LGSS. Where transactions are recharged to LGSS they should be supported by appropriate evidence and approval from both budget managers prior to posting.

Recharges posted in order to reallocate costs should be reviewed by management and removed from the LGSS costs centres. This will result in a smaller number of transactions within the LGSS cost centres which will speed up the accounts production and audit process.

b. 2018/19 Agresso financial reporting

As part of the implementation of Agresso and set up of LGSS within its own ledger, see recommendation 1, management should implement a new process where all income is invoiced by LGSS and all costs are invoiced to LGSS regardless of whether a Host Authority is involved in the transaction, this will remove the need to undertake recharging and provide a robust audit trail of evidence. This will ensure that only transactions relating to LGSS are recognised and they are supported by appropriate accounts receivable and accounts payable processes.

b. 2018/19 Agresso financial reporting

Management Response

Agreed, this is being factored in to the change in the financial reporting arrangements for LGSS as per the response to recommendation 1b.

Owner

Director of Finance

Deadline

31 March 2019

Low priority

3. Milton Keynes cost centres

Our audit procedures identified the inclusion of the Profit Centre 243001 "Ser Dir Fin Resource" which included a number of items that decreased income and expenditure due to "Goods receipt/Invoice receipts tidy up". Management confirmed this cost centre was used as a control account to relocate costs. The total value of these transactions within LGSS was £1.596 million. These transactions netted to nil within the LGSS accounts as costs are allocated into the cost centre and then subsequently removed and allocated to Milton Keynes cost centres. However, the accounting treatment of reducing income and expenditure is not corrected and has been reported in Appendix 3 and corrected by management.

Although these transactions netted to zero, and therefore had no impact on the financial statements, their inclusion, despite not relating to LGSS, increases the possibility of inappropriate or inaccurate transactions being included within the accounts.

Recommendation

Management should remove the "Goods receipt/invoices receipt tidy up" cost centres from the LGSS accounts to reduce the risk of error of misstatement. All cost centres should be reviewed for appropriateness.

Management Response

Agreed, however the transactions relating to this audit finding have been removed from the LGSS accounts. Management will continue to ensure that the 'goods receipt / invoices receipt tidy up' transactions are not included in the LGSS cost centres for compiling the accounts in future years.

A review of the cost centres will also be undertaken as recommended to ensure that only those relevant to LGSS are included in the reports required to prepare the accounts.

Owner

Head of Integrated Finance

Deadline

31 March 2018

Control environment issues and recommendations

High priority

4. Audit readiness and timings

We were previously due to commence the LGSS audit in September 2017 to allow the Closedown team sufficient time to complete the Host Authority audits. However we agreed with management on 22 May 2017 to move our on-site audit work to start 14 August subject to the following:

- Draft accounts prepared and quality review by management at 31 July 2017; and
- All PBC requests provided on day one of the audit. All PBC working papers should be clearly referenced to the numbers and/or note in the accounts and should reconcile to the balance from the three authority ledgers thus providing a clear audit trail.

Following our final accounts visit a number of issues arose causing us to come off-site. When we returned onsite to LGSS to undertake the audit we encountered further delays, requiring additional KPMG staff time. We have summarised our audit delays below:

- Prepared by client working papers not provided at the start of our final accounts visit on 14 August 2017;
- Many working papers provided were not reconciled to the Statement of Accounts resulting in adjustments to the Statement of Accounts and delays to our sample selection;
- Delays in receipt of evidence for Milton Keynes sampled transactions due to staff unavailability within the Milton Keynes Closedown team. This resulted in delays in concluding our sample testing; and
- Delays in response audit queries leading to delays in concluding audit testing.

These delays arose despite the agreement with management in May over the revised audit timings and the subsequent meeting on 10 August 2017 where the Closedown team confirmed the availability of prepared by client requests ready for our audit start on 14 August 2017.

The impact of these delays resulted in delays to us being unable to conclude our testing and ultimately the sign off of the Statement of Accounts resulting in additional KPMG staff time to complete the audit.

(continued overleaf)

Management Response

Agreed, as per our response to recommendation 1a the Integrated Closedown Team is working on the planned approach to close the Partner authority accounts by the earlier deadlines. The timing of the LGSS accounts will be considered as part of this overall approach to planning for the 2017/18 financial statements.

Owner

Head of Integrated Finance

Deadline

30 January 2018

(continued)

Recommendation

LGSS produce non-statutory Statement of Accounts and therefore do not have an accounts production and audit deadline as required for Local Authority audits.

Management should review the timings of the accounts production and audit process for LGSS and set out an appropriate timeline for the process. This should incorporate the following key factors:

- Conclusion and sign off of the Host Authority audits;
- Closedown team holiday and availability;
- Closedown team support in Milton Keynes to support with queries on items within the Milton Keynes ledger; and
- Appropriate time to produce supporting working papers that reconcile to the LGSS Statement of Accounts.

Medium priority

5. Approval of restructuring costs

Following the integration of Milton Keynes Council into LGSS there was a restructure to the LGSS target operating model. The restructure project was proposed to the Joint Committee on 18 August 2016. This proposal did not include the financial costs to the programme. The total restructuring costs, including redundancy and pension strain costs were £0.7 million, therefore there was no Joint Committee oversight of the total programme costs.

Without appropriate oversight there is a risk that LGSS does not achieve value for money within a restructure programme.

Recommendation

Where future restructuring takes place management should ensure that any programme is costed and proposed to the Joint Committee for approval. This will ensure that significant expenditure is appropriately challenged by those charged with governance in order to ensure it is appropriate and delivers value for money.

Management Response

Any restructuring proposals are fully costed. This is done in line with the LGSS Scheme of Delegation, which sets out the delegation to the Managing Director and other LGSS Directors as follows:

"LGSS Directors have responsibility for the operational management of the Shared Services, including authority to determine the number, grade, title and nature of staff deployed and all other terms and conditions, in addition to ensuring their proper management within the remit of those services for which they are allocated responsibility by the LGSS Managing Director".

With regards the specific example identified for the LGSS TOM, this was part of the business case for MKC joining LGSS as a third Partner. This was fully costed in terms of savings and transitional costs to achieve the new TOM. The business case was reported and approved through the Council meetings of each LGSS Partner in January 2016 and then the TOM restructure was the next stage in this process which was presented to the Joint Committee in August 2016 following which restructuring of various services has taken place in line with the LGSS Scheme of Delegation.

As we have done in this instance management will present to the Joint Committee any future restructure programme with the supporting financial analysis.

Owner

LGSS Managing Director and LGSS Directors

Medium priority

6. Recognition of LGSS Law dividend

The 2016/17 LGSS draft Statement of Accounts includes income recognised from a dividend to be paid by LGSS Law. This has been summarised in Appendix 3 as an adjusted audit difference. The total dividend payment of £267,000 has been taken from the LGSS Law internal reporting rather than the statutory accounts. This is due to the financial statements being fundamentally different to the internal outturn reporting.

This income cannot be recognised within the LGSS accounts for the following reasons:

- LGSS is not a shareholder of LGSS Law therefore cannot recognise the LGSS Law dividend as income within their accounts. The dividend would be recognised as income within the shareholder's accounts: Northamptonshire County Council, Cambridgeshire County Council and Central Bedfordshire Council.
- LGSS Law is yet to declare their dividend at a Directors meeting. This is expected to be completed at the shareholder's meeting in December 2017. As the dividend is not declared it is not committed to as per the Companies Act 2006. Therefore it should not be recognised within the 2016/17 accounts of LGSS.

Recommendation

LGSS intend to recognise income from LGSS Law dividends in the future. In order to do this the following will need to be in place:

- Declaration by LGSS Law Directors prior to or within appropriate period of the year-end to recognise the dividend within the financial year; and
- Mechanism where the dividend can be paid over to LGSS by Northamptonshire and Cambridgeshire County Councils as the shareholders of LGSS Law, as LGSS is not entitled to recognise the dividend as income.

Management Response

This recommendation is agreed and the arrangements for LGSS recognising and accounting for any dividend from LGSS Law paid to its owners. This will consist of a review of the arrangement to formalise the approach as well as ensuring through the LGSS Law Board that any dividend to be distributed is done in a timely manner to enable inclusion in both the County Council accounts and the subsequent payment on to LGSS by the County Councils.

Owner

Director of Finance

Deadline

31 March 2018

Low priority

7. Integration of new Host Authorities

Milton Keynes joined LGSS from 1 April 2016. Milton Keynes' Balance Sheet items prior to joining were not expected to be included within the LGSS accounts.

Our testing identified £361k of reversing accruals, reducing LGSS expenditure, which had been recognised in period one of 2016/17.

We also identified differences between the spend Milton Keynes accrued in 2015/16 and the actual expenditure incurred. Whilst the difference is small management did not ensure an appropriate cut off of the Milton Keynes ledger on integration into LGSS. There is a risk that material transactions that don't relate to LGSS are included within the Statement of Accounts.

Recommendation

When additional authorities are integrated into LGSS, management should devise a clear process for identifying Balance Sheet items between LGSS and the Host Authority. This will ensure that Authority transactions are not included within the LGSS Statement of Accounts.

Management Response

Agreed, given Milton Keynes was the first full Partner to join the existing two Councils in LGSS we will apply the lessons learnt to develop a clearer process to ensure the appropriate cut off arrangements are in place for the future.

Owner

Head of Integrated Finance

Deadline

31 March 2018

Follow-up of prior year recommendations

In the previous year, we raised fours recommendations which we reported in our *External Audit Report 2015/16 (ISA 260)*. LGSS has not implemented all of the recommendations. We re-iterate the importance of the outstanding recommendations and recommend that these are implemented by LGSS.

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	1	1	-
Medium	2	2	-
Low	1	1	**1**
Total	**10**	**3**	**13**

High priority

1. LGSS Financial Systems

As LGSS is not a separate legal entity it has been set up as a cost centre on the general ledgers of Northamptonshire County Council and Cambridgeshire County Council respectively. As a result the accounts closedown process is time-consuming, more complicated and less efficient than equivalent processes for similar organisations.

Which in turn meant we were unable to place reliance on controls due to the requirement to test controls across two ledgers, and instead had to undertake much more time consuming substantive testing.

In addition, due to the complex methodology used in compiling the Financial Statements this has led to the audit identifying a number of adjustments to be made by management and additional external audit testing to be performed.

Recommendation

As LGSS continues to grow, bringing in Milton Keynes following the yearend, it is now time to critically consider the financial systems and processes used by LGSS and implement a structure and/or system and processes that are more appropriate to the nature and size of the organisation. This will help to improve the controls in operation, accuracy of data, efficiency of the closedown process and ultimately reduce costs to the organisation of time required to prepare the accounts.

Management original response

LGSS recognises that its accounting structure has become increasingly complex as it has expanded in recent years.

LGSS will review its accounting structure and will explore the feasibility of setting up its own standalone General Ledger, in order to separate out its transactions from those of the Councils.

The overarching aim of LGSS when producing accounts is to make them as easy to read and understandable to the reader as possible. LGSS is committed to delivering this, and will continue to utilise the interim audit in order to run through proposed methodology with the external auditors and to work towards implementing changes to make the audit process smoother.

LGSS will also explore the possibility of other potential changes to systems/processes, such as reviewing the feasibility of setting up its own bank account.

Owner

LGSS Director of Finance / LGSS Head of Integrated Financial Services / LGSS Head of Business Planning and Finance.

Original deadline

This will be a major undertaking, the review to be completed by June 2017 for implementation in 2017-18. The ERP Gold implementation needs to be completed first.

(continued overleaf)

KPMG's November 2017 assessment

Recommendation superseded

This recommendation has been superceded by Recommendation one raised as part of our 2016/17 non-statutory audit.

Management's November 2017 response

Noted.

Medium priority

2. Quality of Prepared by Client working papers and responses to audit queries

We have noted an improvement in the clarity of LGSS's workings with regard to consolidating the two ledgers into the LGSS Financial Statements.

However, throughout the audit we identified a number of issues where working papers provided by LGSS could not be agreed to the Financial Statements and/or errors were identified. This created delays in the audit as we were unable to test balances as working papers were not sufficiently complete to enable robust audit testing to occur.

Our requests for further audit evidence, such as invoices for sample testing, also had significant delays of up to 35 days from the date requested, causing further audit delays.

Recommendation

LGSS should review its closedown process for 2016/17 and carefully consider any stretch targets for completion of working papers. LGSS should review the capacity on the Closedown Team to meet such targets, taking into consideration the Finance Team's workload also.

Management original response

The preparation of the 2015-16 accounts has been the first year that LGSS has utilised an Integrated Closedown team. This team has prepared the accounts for LGSS, NCC and CCC. Producing these accounts and managing the subsequent audits simultaneously across the organisations has been challenging.

LGSS will undertake a full debrief following the conclusion of the 2015-16 audit, looking at lessons learned and continuing to implement improvements for the future.

A restructure of the Finance directorate has just been completed. This has included further strengthening of the Closedown function, and due consideration has been given to ensure that the team is appropriately resourced.

Consideration will be given to the scheduling of the accounts production process, and of the audit fieldwork, when compiling the 2016-17 Closedown timetable to ensure that adequate resources are available to fulfil the required tasks.

Owner

LGSS Head of Integrated Financial Services

Original deadline

Restructure completed December 2016.

Other aspects to be completed prior to audit of 2016-17 Accounts.

KPMG's November 2017 assessment

Recommendation superseded

This recommendation has been superceded by Recommendation four raised as part of our 2016/17 non-statutory audit.

Management's November 2017 response

Noted.

Medium priority

3. Compliance with the CIPFA code requirements

2015/16 was the first year LGSS were not legally required to produce financial statements. However, LGSS decided that they would, in the interests of openness and good governance, continue to produce financial statements. In doing so they have elected to apply the CIPFA Code of Practice on Local Authority Accounting.

However, in undertaking our audit we identified a number of instances where disclosures required under the Code had been omitted and therefore these were required to be corrected by management.

Recommendation

LGSS should ensure that it continues to comply with the accounting requirements of the Code and ensure that any changes to the requirements are reflected in future LGSS financial statements.

Management original response

LGSS will continue to use the CIPFA Code of Practice as the basis of preparation for its Statement of Accounts in order to allow comparability with the accounts of the County Councils, which are prepared on that basis.

In preparing its accounts LGSS has sought to balance the requirements of the Code with the desire to make the accounts understandable to the reader. On occasions this has required judgements to be made on the way to present particular items.

For example, as LGSS's operations are considered to be trading income/expenditure the Code requires that they be presented as Financing and Investment income/expenditure on the face of the Income and Expenditure Statement. This does not provide the reader of the accounts with a breakdown of these figures by Directorate heading, so this has been shown in an additional table within the accounts.

As 2015-16 has been the first year that LGSS Law has been trading it has been the first year that group accounts have been prepared. Upon preparation of the draft accounts judgements were made regarding the disclosures that would be required in respect of the consolidated LGSS Law statements. Following discussion with the auditors during the course of the audit it was agreed that some additional disclosures would be required. These have been included in the final set of accounts. For example disclosures have been added in respect of the defined benefit pension scheme.

For the preparation of the 2016-17 accounts Officers will discuss any potential changes in presentation with the auditors at an early stage in the preparation process, in order to minimise changes required during the audit.

Owner

LGSS Closedown Group Accountant

Original deadline

Prior to the production of the 2016-17 LGSS Statement of Accounts.

(continued overleaf)

(continued)

KPMG's November 2017 assessment

Fully implemented

LGSS have complied with the CIPFA code of practise when producing the 2016-17 Statement of Accounts. This includes the restatement of the CIES.

Our audit testing identified one adjustment for dividend income which has not been recognised in line with the CIPFA Code of Practise. This has been corrected by management.

Management's November 2017 response

Noted.

Low priority

4. Journal entries

Journals can be requested by anyone within the LGSS Finance team without any prior management authorisation. There are no limits on the value of the journals.

An annual review is in place however, the individual performing the review posts journals themselves, indicating a lack of segregation of duties. They are also required to review journals posted by more senior staff members, which they may be less likely to question or challenge if they seem unusual.

Recommendation

LGSS should consider exploring available options to improve its journal controls, including how the system can be utilised to support improved:

- segregation of duties regarding the authorising, posting, reviewing and reconciling of journal entries;
- access rights controlling who is authorised to record and approve journal entries along with the posting and authorisation limit; and
- oversight of the journal entry-posting process by members of management including post-entry review based on a defined risk based approach.

Management original response

Journals can only be posted by staff with the appropriate responsibilities and sufficient professional knowledge. These staff are predominantly within the Finance, Pensions and Transactions teams. This functionality is not generally given to staff in the wider organisation.

A validation process is undertaken prior to each journal being loaded. This checks that the template has been completed correctly and that the required information has been provided.

Whilst there is no explicit approval at the point of entry, there are procedures in place to identify misspostings retrospectively. Budget managers review the transactions posted against their budget groups as part of the monthly budget monitoring process. Finance Business Partner teams also scrutinise transactions and balances as part of this process.

LGSS is currently in the process of implementing the ERP Gold system. Consideration will be given to ensure that an appropriate journal entry process is instigated in the new system.

Owner

LGSS Director of Finance

Original deadline

April 2017.

KPMG's November 2017 assessment

Not implemented

There has been no change to the authorisation arrangements. However, we anticipate this will be implemented upon migration to Agresso later in 2017/18.

Management's November 2017 response

The new ERP Gold system will enhance the journal authorisation processes once implemented.

Owner

Director of Finance

Original deadline

1 April 2018.

Audit differences

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which in your case is the Joint Committee). We are also required to report all material misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities.

A number of minor amendments focused on presentational improvements have also been made to the 2016/17 draft financial statements. We are committed to working with the LGSS Closedown team to continuously improve the quality of the financial statements submitted for audit in future years.

Adjusted audit differences

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

Table 1: Adjusted audit differences (£'000)

No.	Income and expenditure statement – income	Income and expenditure statement - expenditure	Assets	Liabilities	Reserves	Basis of audit difference
1	Dr Gross Income £560k	Cr Gross Expenditure £560k				Incorrect inclusion of depreciation costs. LGSS do not hold fixed assets.
2	Dr Gross Income £270k	Cr Gross Expenditure £270k				Incorrect inclusion of pensions adjustment costs. LGSS do not hold pension liabilities on the LGSS Balance Sheet.
3	Cr Gross Income £1,596k	Dr Gross Expenditure £1,596k				Remove cost center transactions that don't relate to LGSS. This is a summary of the finding detailed in Appendix One Recommendation 3.
4	Cr Gross Income £2,819k	Dr Gross Expenditure £2,819k				Sales invoices incorrectly included in non-pay expenditure that should have been recognised in income.
5	Dr Gross Income £276k		Cr Short term debtors £276k			Adjustment for LGSS Law dividend incorrectly recognised. See detail below.
	Cr £5,521k	**Dr £5,245k**	**Cr £276k**	**-**	**-**	**Total impact of adjustments**

LGSS Law dividend income

LGSS had recognised income from a dividend to be paid by LGSS Law within their draft Statement of Accounts. This transaction cannot be recognised within the LGSS accounts for the following reasons:

- LGSS is not a shareholder of LGSS Law therefore LGSS cannot recognise the dividend as income within their accounts. These should be recognised as income within the shareholder's accounts: Northamptonshire County Council, Cambridgeshire County Council and Central Bedfordshire Council.
- LGSS Law is yet to declare their dividend at a Directors meeting. This is expected to be completed at the shareholder's meeting in December 2017. As the dividend is not declared it is not committed to as per the Companies Act 2006. Therefore it should not be recognised within the 2016/17 accounts.

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 June 2017.

Materiality for LGSS's accounts was set at £775,000 which equates to around 1 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

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 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 LGSS, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £38,000 for LGSS.

Where 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.

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.

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 Joint 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 LGSS for the financial year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and LGSS, 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 in relation to independence and objectivity.

Appendix 6

Audit fees

Audit fees

As communicated to you in our External Audit Plan 2016/17, our base fee for the audit is £22,450 plus VAT *(£24,500 in 2016/17)*, which is a reduction of 8.4% from the prior year. See table below for further detail.

Fee table		
Component of audit	**2016/17** *(planned fee)* £	**2015/16** *(actual fee)* £
Accounts opinion work		
Proposed Audit Fee per our External Audit Plan	22,450	24,500
Additional work to conclude our opinions (note 1)	TBC	10,025
Total fee for LGSS	**TBC**	**34,525**

All fees are quoted exclusive of VAT.

Note 1: Accounts opinion and use of resources work

For 2016/17, due to the number of delays to the audit process and issues with the quality of audit working papers we will discuss our proposed additional fee in detail with the Director of Finance on the conclusion of our audit.