KPMG

External Audit Report 2015/16

Sheffield City Council

—

September 2016

Contents

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. Public Sector Audit Appointments issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

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

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Trevor Rees, the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers (on 0207 694 8981, or by email to andrew.sayers@kpmg.co.uk). After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3H.

Section one: Introduction

Introduction

This document summarises:

- **The key issues identified during our audit of the financial statements for the year ended 31 March 2016 for the Authority; and**
- **Our assessment of the Authority's arrangements to secure value for money.**

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Scope of this report

This report summarises the key findings arising from:

- Our audit work at Sheffield City Council ('the Authority') in relation to the Authority's 2015/16 financial statements; and
- The work to support our 2015/16 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

Financial statements

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

Planning → Control Evaluation → Substantive Procedures → Completion

This report focuses on the third stage of the process: substantive procedures. Our on site work for this took place during July and August 2016.

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

VFM Conclusion

Our External Audit Plan 2015/16 explained our risk-based approach to VFM work. We have now completed the work to support our 2015/16 VFM conclusion. This included:

- Assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion;
- Considering the results of any relevant work by the Authority and other inspectorates and review agencies in relation to these risk areas; and
- Carrying out additional risk-based work.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our audit work in relation to the 2015/16 financial statements of the Authority and the fund.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1. We have also reviewed your progress in implementing prior recommendations.

Acknowledgements

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

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Section two: Headlines

Headlines

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

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

Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2016. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.
Audit adjustments	Our audit has identified a total of one audit adjustment with a total value of £5.31 million. The impact of these adjustments is to: — Increase the balance on the general fund as at 31 March 2016 by £5.31 million; and — Reinstated the balance on NNDR debtors by £5.31 million. — Increase the net worth of the Authority as at 31 March 2016 by £5.31 million. We have included detail of this audit adjustment at Appendix two. This was adjusted by the Authority. We have raised a related recommendation regarding the calculation of bad debt provisions, which is summarised in Appendix one.
Key financial statements audit risks	We review risks to the financial statements on an ongoing basis. We identified no significant risks specific to the Authority during 2015/16 with respect to the financial statements.
Accounts production and audit process	We received complete draft accounts on 31 May 2016 ahead of the DCLG deadline of 30 June 2016. The authority successfully completed the accounts close process a month earlier than previously in preparation for the early close down that will be required in 2017-18. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code. The Authority has implemented all of the recommendations in our *ISA 260 Report 2014/15* relating to the financial statements. The Authority has sound processes in place for the production of the accounts and supporting working papers. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales. There were some delays in obtaining information via outsourced providers, in particular with regards to payroll data. We will debrief with the finance team to share views on the final accounts audit. Hopefully this will lead to further efficiencies in the 2016/17 audit process. We would like to thank Authority Officers who were available throughout the audit visit to answer our queries.

Headlines (cont.)

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

This table summarises the headline messages. The remainder of this report provides further details on each area.

VFM conclusion and risk areas	Our VFM Risk Assessment identified the following two risk areas: — The financial performance and management of the Communities portfolio (following on from issues identified in previous periods with regards to the financial performance of Adult Social Care). — The performance of the Place portfolio with particular regard as to whether significant contracts with Veolia and Kier were able to deliver the budgeted level of savings. We have worked with officers throughout the year to discuss these VFM risks and our detailed findings are reported in section 4 of this report. There are no matters of any significance arising as result of our audit work in these VFM risk areas. 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 VFM conclusion by 30 September 2016.
Completion	At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas: — Agreeing final adjusted financial statements to expected adjustments and audit work performed. — Some queries outstanding with regards to Whole of Government Accounts, largely as a result of central government delays in issuing template for completion. You are required to provide us with representations on specific matters such as your going concern assertion and whether the transactions in the accounts are legal and unaffected by fraud. We provided a draft of this representation letter to the Section 151 Officer on 26 August 2016. We draw your attention to the requirement in our representation letter for you to confirm to us that you have disclosed all relevant related parties to us. We are asking management to provide specific representations on the following: - The reasonableness of the Major Sporting Facilities (MSF) asset valuation used as a basis for calculating the value of the long term debtor due from Sheffield City Trust (being the future transfer of the MSF assets from Sheffield City Trust to the Council). This is in the absence of a full specialist valuation having been undertaken in the year due to time and cost constraints. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.

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Section three: Financial Statements

Proposed opinion and audit differences

We propose issuing an unqualified audit opinion.

We have not identified any issues in the course of the audit that are considered to be material.

We have identified one significant audit adjustment.

The wording of your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Audit and Standards Committee on 15 September 2016.

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 (see Appendix two for more information on materiality) level for this year's audit was set at £27 million. Audit differences below £1.35 million are not considered significant.

We did not identify any material misstatements.

Our audit identified one significant audit difference, which we set out in Appendix two. This has been adjusted in the final version of the financial statements.

Annual governance statement

We have reviewed the Annual Governance Statement and confirmed that:

— It complies with *Delivering Good Governance in Local Government: A Framework* published by CIPFA/SOLACE; and

— It is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

The net impact on the General Fund and HRA as a result of audit adjustments is to increase the balance as at 31 March 2016 by £5.31 million. This is a result of restating the debtors balance against NNDR £5.31 million as a result of initial accounting / administrative error.

Significant audit risks

We have worked with the Authority throughout the year to discuss significant risks and key areas of audit focus.

This section sets out our detailed findings on those risks.

In our *External Audit Plan 2015/16* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. These risk areas were Management override of controls and the Fraud risk of revenue recognition. We did not identify any further significant risk areas.

The table below sets out the outcome of our audit procedures and assessment on these risk areas.

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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 2015/16 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.

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Other areas of focus

In our External Audit Plan 2015/16, presented to you in March 2016, we identified 2 areas of audit focus. These are not considered as significant risks but areas of importance where we would carry out some substantive audit procedures to ensure there is no risk of material misstatement.

We have now completed our testing. The table sets out our detailed findings for each area of audit focus.

Better Care Fund

The Sheffield Better Care Fund was set up as a pooled budget – a partnership arrangement whereby Sheffield CCG and Sheffield City Council contribute an agreed level of resource into a single pot (the 'pooled budget') that is then used to commission or deliver health and social care services. The Better Care Fund was established in order to help encourage more joined up practice with regards to the provision of health and social care services across the NHS and local authorities.

For 2015/16 the combined financial contribution (as set out within the Section 75 Agreement) from the two partners was £270.5m of revenue and £3.5m of capital, totalling £274.0m (of which £108m relates to SCC including the capital element).

There are various accounting standards that apply to pooled budgets including IAS 28 Investments in Associates and Joint Arrangements, IFRS 10 Consolidated financial statements, IFRS 11 Joint arrangements and IFRS 12 Disclosure of Involvement with Other Entities.

Given that these arrangements were new and the accounting standards applicable may not be familiar there is a risk that the relevant disclosures and treatments are incorrect.

Findings / Work Performed

We reviewed the treatment of the BCF arrangements to confirm they are in accordance with the requirements of the relevant accounting standards. More specifically we:

- Reviewed the financial reporting implications of the arrangements in place;
- Considered the processes in place to ensure the information requirements of the parties involved are met;
- Assessed how the funds operate, ensuring that gross arrangements are fully agreed and understood by all parties and correctly applied in practice by the Authority; and
- Checked that the BCF arrangements in place are correctly accounted for within the Authority's financial statements and that appropriate disclosure of pooled budget arrangements are made (in line with *IFRS 12 Disclosure of Interests in Other Entities).*

The accounting treatment was found to be in accordance with the requirements of the relevant accounting standards, the review of the S75 agreement confirmed that the accounting arrangements have been agreed by the CCG and Sheffield City Council. Our review of the pooled budget accounting and the disclosure note did not identify any issues arising.

Other areas of focus

In our External Audit Plan 2015/16, presented to you in March 2016, we identified 2 areas of audit focus. These are not considered as significant risks but areas of importance where we would carry out some substantive audit procedures to ensure there is no risk of material misstatement.

We have now completed our testing. The table sets out our detailed findings for each area of audit focus.

IFRS 13 – Fair Value Measurement

The 2015/16 edition of the Code introduced new, or amended, accounting practices in respect of IFRS 13: Fair Value Measurement. There are no adaptations to IFRS 13 for the public sector context. However, section 4.1 of the Code adapts IAS 16 to require that Surplus Assets (property, plant and equipment) are measured at fair value. Sheffield had £123m (Net Book Value £121.5m, £123m Gross Book Value) of surplus assets as at 31st March 2015 which needed to be revalued and accounted for under fair value. The impact of these revaluations had the potential to be material for the 2015/16 accounts.

Findings

We have reviewed the valuation methodology adopted by the Council for surplus assets. We are satisfied that assets have been valued accordingly using the fair value methodology using an appropriate de-minimis level of £25k in original value. We are satisfied that the remaining surplus assets below the de-minimis level are not material to the financial statements (less than £2m in total value). As per the disclosure in note 14 of the accounts we welcome the Authority's intention to review those assets lower than the de-minimis value moving forward.

Judgements

We always consider the level of prudence within key judgements in your financial statements. We have summarised our view below using the following range of judgement:

Level of prudence

0 1 2 3 4 5 6

Audit difference | Cautious | Balanced | Optimistic | Audit difference

Acceptable range

Assessment of subjective areas				
Asset/liability class	**15/16**	**14/15**	**Balance (£m)**	**KPMG comment**
Provisions	3	3	£31.1 million *(PY: £31.2 million)*	There has been minimal movement on the overall provisions balance. The main addition in the year has been an increase of £5m in the business rates appeals provision as a result of recent rulings e.g. the potential eligibility for GP practices to claim back business rates.
Debtors provisioning / business rate appeals	2	3	£60.9 million *(PY: £59.9 million)*	The bad debt provisioning is prudent in its calculation. We did note that whilst we are satisfied the numbers are materially reasonable there could be some updates made to the methodology, which in some cases was outdated and did not always directly reflect the requirements of IAS39. See recommendation two in appendix one.
Property, Plant and Equipment (valuations / asset lives)	3	3	£2,497.2 million *(PY: £2,370.0 million)*	The valuation methodology and asset lives have been reviewed and are in line with our understanding of the Authority and the wider sector as well being in accordance with the relevant accounting standards.
Pensions Liability	3	3	£856.4 million *(PY: £796.0 million)*	The Authority has largely relied upon the valuation methodology provided by the external actuary. We have seen evidence that the Authority has challenged some of the assumptions made by the actuary and the assumptions are in line with our own experience of the sector.
MSF Debtor Value	3	n/a	£70.9 million *(PY: N/A)*	This debtor value is based upon the reversionary value of MSF assets that the Council has a reversionary interest in (estimated value at 2024). This value has been reached by taking the latest valuation and discounting this to present value from when the assets are expected to transfer to the Authority in 2024. In the absence of a full specialist valuation this is a reasonable methodology.

Accounts production and audit process

Draft accounts were produced earlier than in previous periods with a draft submitted to audit on 31 May 2016.

The audit process could be completed within the planned timescales.

The Authority has implemented all of the recommendations in our ISA 260 Report 2014/15.

Accounts production and audit process

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

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority has speeded up its financial reporting and closedown process in preparation for the earlier closedown and accounts sign-off required from 2017/18 onwards. We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 31 May 2016. The only significant area outstanding in this draft was an updated valuation for the long term debtor held in relation to MSF assets.
Quality of supporting working papers	The supporting working papers provided were generally of a sound quality. We shall work with officers moving forward to ensure our requirements are clearly outlined, where possible, to enable the provision of required information.
Response to audit queries	Officers resolved the majority of audit queries in a reasonable time. In some cases, however, we experienced delays, specifically where staff were either unavailable or there were difficulties obtaining data from third party providers.

Additional findings in respect of the control environment for key financial systems

During the course of our audit a number of control environment issues have become apparent. These are briefly summarised below with further detail seen in our recommendations section at Appendix One:

1. Housing benefits (private housing). Reconciliations between the Housing Benefits Academy system and the OEO General Ledger system are not carried out on a regular basis and data could not be agreed back to the source system. (Recommendation 1)
2. Bad Debt Provisions. A number of observations were made with regards to bad debt provisions, including the use of outdated calculation methodologies, over provision of sundry debtors, errors in the NNDR provision posted and a large number of old debts not written off. (Recommendations 2 & 5)
3. The Authority has not undertaken a full revaluation in year of the Major Sporting Facilities to which the value of its long term debtor is associated. Whilst satisfied that this has not resulted in a material misstatement we would usually expect a full specialist valuation to have been carried out when related to such a material figure. (Recommendation 3)
4. We noted that for a number of key IT systems operated by outsourced providers, independent assurance was not obtained in year with regards to the control environment around these systems. (Recommendation 4)
5. The Authority is currently developing a digital strategy from which a new IT strategy will be further developed. In the interim there is not an up to date IT strategy document in place. (Recommendation 6)

Prior year recommendations

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

The Authority has implemented all of the recommendations in our *ISA 260 Report 2014/15.*

Completion

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

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

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

Declaration of independence and objectivity

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

In relation to the audit of the financial statements of Sheffield City Council for the year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and Sheffield City Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix four 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 Interim Head of Finance for presentation to the Audit and Standards Committee. We require a signed copy of your management representations before we issue our audit opinion.

We are asking management to provide specific representations on the following:

The reasonableness of the Major Sporting Facilities (MSF) asset valuation used as a basis for calculating the value of the long term debtor due from Sheffield City Trust (being the future transfer of the MSF assets from Sheffield City Trust to the Council). This is in the absence of a full specialist valuation having been undertaken in the year due to time and cost constraints.

Other matters

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

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

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report.

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Section four: Value for Money

VFM Conclusion

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.

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.

Background

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'.

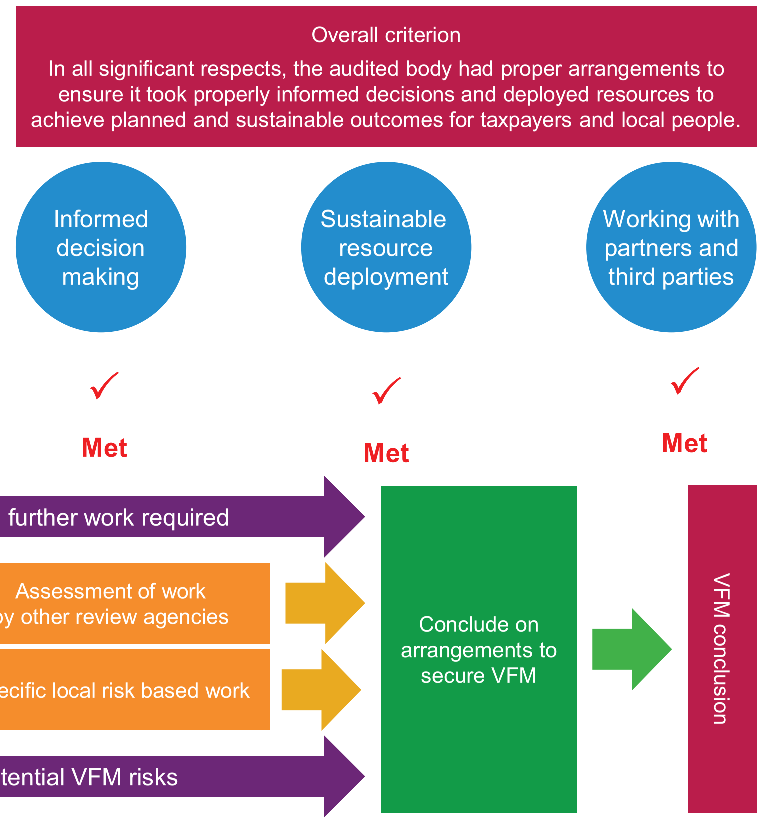
This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to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

The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria.

These sub-criteria provide a focus to our VFM work at the Authority.

Conclusion

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.



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Specific VFM Risks

We have identified two specific VFM risks.

In all cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

Work completed

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

— Assessed the Authority's key business risks which are relevant to our VFM conclusion;

— Identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;

— Considered the results of relevant work by the Authority, inspectorates and review agencies in relation to these risk areas; and

— Considered in more detail the financial performance and monitoring of the Place and Communities portfolio in line with identified risks.

Key findings

Below we set out the findings in respect of those areas where we have identified a residual audit risk for our VFM conclusion.

We concluded that we did not need to carry out additional work for these risks as there was sufficient relevant work that had completed by the Authority, inspectorates and review agencies in relation to these risk areas.

Specific VFM Risks (cont.)

We have identified two specific VFM risks.

In all cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Commun-ities	As detailed in previous VFM work carried out by ourselves we noted that Adult Social Care may not have appropriate budget monitoring and oversight in order to meet its budget. We noted from initial conversations with management that the portfolio (Communities) was again expected to not meet budget. Given issues identified previously we considered this to be a VFM risk. This is relevant to the informed decision making and sustainable resource deployment sub-criteria of the VFM conclusion.	We noted that regular reports continued to go to Audit and Standards Committee highlighting the progress being made in terms of budget monitoring and cost controls. We noted that this work continues to be ongoing with the portfolio continually striving to improve. We also noted from budget and the final outturn reports that the position was reported upon throughout the year and was understood. The final overspend of £950k was forecast and understood. We were satisfied from review and discussion of internal processes that there was relevant monitoring and actions with regards to the performance of the portfolio. We were satisfied that the level of internal scrutiny was appropriate to effectively manage the identified risk. **Specific risk based work required? No**

Specific VFM Risks (cont.)

We have identified two specific VFM risks.

In all cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Place - Contracts	Conversations with senior officers and review of budget monitoring documentation highlighted that there was a risk around the waste contract and highways (streets ahead) contract held with third parties. There was a risk that the portfolio was not able to deliver cost reductions from these contracts This is relevant to the sustainable resource deployment, working with partners and third parties sub-criteria of the VFM conclusion.	We noted from review of the Authority's budget monitoring information that the overspend against these contracts was monitored and relevant officers were aware of any issues. Whilst pressures were being experienced against these two key contracts savings were also found elsewhere. To an extent the nature of the contract performance and costs incurred were a matter of historic and other factors outside of the portfolios control e.g. original contract terms and increase in households and associated waste requirements. Given the budget monitoring and the awareness of all relevant officers of the issues we were satisfied that the level of scrutiny and oversight was appropriate to secure value for money. The final outturn position was a £2,975k overspend on a revenue budget of £156,215k therefore representing approx. 1.9% overspend. **Specific risk based work required? No**

Appendices

Key issues and recommendations

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

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

We will formally follow up these recommendations during the 2016/17 audit period.

Priority rating for recommendations					
1	***Priority one***: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	2	***Priority two***: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	3	***Priority three***: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
1	1	**Housing Benefits Reconciliation (Private Housing)** Housing benefits transactions are posted to the OEO ledger system by Capita staff reflecting the source data from the Academy Housing Benefits system. Testing found that regular documented reconciliations are not performed by Authority officers to ensure that the ledger reflects the source data from Academy. Whilst officers do carry out adhoc reconciliations utilising a spreadsheet provided by Capita colleagues it was noted that this spreadsheet does not tie back to the data held on the Academy system due to a number of adjustments that are subsequently posted. Whilst satisfied that this has not resulted in a material misstatement, and any differences between the two systems may well be justified, without a reconciliation process we are unable to verify the reasonableness of any adjustments posted. **Recommendation** Roles and responsibilities with regards to the performance of reconciliations should be clarified between Capita and the Authority's own team. This should include an agreed timeframe and method for recording and adjusting transactions that might impact upon the reconciliation.	**Management Response** The Revenue and Benefits service is managed by Capita on behalf of the Council. Their duties include submitting monthly reconciliations for the Academy system to the Council, which are then checked to the financial ledger by Finance Business Partner. Whilst there is no evidence of significant discrepancies, officers will work with Capita to clarify the roles and responsibilities and ensure that the process is complete and formalised for all stages of reconciliation (including submission of source data to support the monthly reconciliations), without duplicating the effort of the either party. **Responsible Officer** Assistant Director – Finance Business Partner (Resources) **Due Date** December 2016

Key issues and recommendations

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

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

We will formally follow up these recommendations during the 2016/17 audit period.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
2	2	**Bad Debt Provisions** Testing of the bad debt provision balance highlighted a number of concerns. These included: - A failure to recognise the requirements of IAS39 when making a provision, including the need to identify clear 'trigger' points for a provision to be made, including the use of historical experience as opposed to the use of a blanket percentage approach. - The use of some out dated methodologies both in utilising the blanket percentage approach highlighted above, but also the use of outdated guidance e.g. with regards to the provision for housing tenants bad debt was provided based upon guidance issued by central government in 1990. - We also noted that there had been an error in posting of NNDR debtors resulting in the debtors balance being understated by £5.31m. Our audit highlighted that this had resulted in a bad debt provision higher than the related debtor balance held. - Sundry debtor provisions (circa £6.5m) were posted to the accounts utilising the internal methodology of providing for all balances over 60 days. This does not recognise that many balances over 60 days would subsequently be collected. **Recommendation** The Authority should review the methodologies utilised for creating bad debt provisions to ensure these are in line with the requirements of IAS39, latest guidance and accurately reflect the pattern of collection over a period of time.	**Management Response** The debtor balances in the financial statements cover many different services and there are several local approaches to calculating the bad debt provision. Strategic Finance will work with the debtor teams to review the current methodologies and ensure that the provisions are compliant with IAS39. The NNDR balance was amended in error, late in the accounts production timetable, and has since been corrected for the final Statement of Accounts. **Responsible Officer** Assistant Director – Strategic Finance **Due Date** March 2017

Key issues and recommendations

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

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

We will formally follow up these recommendations during the 2016/17 audit period.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
3	2	**Major Sporting Facilities – Long Term Debtor Valuation** The Council currently holds a long term debtor in its financial statements recognising its future option of rights to the major sporting facilities assets currently held and operated by Sheffield City Trust. This debtor value is the reversionary interest that the Council holds in these assets as at 2024 when the option could be exercised. The value of circa £70.9m that the debtor is held at is based upon the latest available valuation of the assets (2012/13) that has been discounted to reach a value as at 2024. Due to the specialist nature of the assets and the short timescales available, the Council was unable to undertake a new valuation in house. The timescales, and prohibitive cost, have also meant an external valuation was not able to be undertaken in year. Whilst we are satisfied that the current value is not materially wrong, further assurance could be gained with regards to the value of the debtor were a more up to date specialist valuation undertaken. **Recommendation** The Authority should consider the requirement for a full specialist valuation of the related MSF assets to be undertaken in the 2016/17 period.	**Management Response** Officers will explore options with in-house surveyors, Sheffield City Trust and KPMG, to find a pragmatic approach to valuing the Council's reversionary interest in the assets at 2023/24. **Responsible Officer** Assistant Director – Strategic Finance **Due Date** March 2017

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Key issues and recommendations

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

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

We will formally follow up these recommendations during the 2016/17 audit period.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
4	2	**IT System Assurance** The Authority has a number of IT systems in place that have an impact upon the financial information reported. These systems include HR, payroll, housing benefits, council tax, NNDR and fixed assets. The Authority has a number of operating models in place, depending upon the operational area in question. For instance, some services are wholly outsourced, some areas the service might be outsourced but the related IT system is managed internally, as well as other variations in operation. Our audit work around IT systems in the year found that for a number of wholly outsourced systems a business decision had been taken not to commission ISAE3402 reports to offer assurances with regards to the IT control environment. We also noted that for the systems we were to place reliance upon these had not been included in the year as part of the scope of internal audit's work. As a result of all of the above, we noted that the Council does not have a clearly documented outline of which systems exist, who manages them and has overall service control, and how they gain assurance that the data inputs and outputs from the system are reliable. Without this clear outline there is a risk that weaknesses in control and operations are not identified and/or managed appropriately leading to a reduction in data integrity. **Recommendation** The Authority should seek to develop an IT assurance framework that clearly highlights the ownership of a system, responsible officers and how assurance is gained regarding the integrity of the data produced.	**Management Response** Corporately managed systems, which make up the majority of SCC's systems catalogue, are known and documented, though we agree that we could improve this and in that respect we have already started work aimed at developing a more complete enterprise architecture to include business systems wherever they are managed currently. In addition, the council has recently approved a SCC-wide project to rationalise applications and put in place new governance that will enable a corporate view of systems to be held and managed, in part to prevent historic instances of future needless duplication. As a part of our objective of having a complete enterprise architecture documented, we will adopt a consistent approach across all parts of the authority, to documenting systems and ensuring the appropriate assurance, controls and governance are in place. This will take the form initially of a SCC systems catalogue but will become a core resource to feed into work on the EA as that develops. Given the current federated approach, collating this information and putting in place effective governance is likely to require input from many different areas, hence the timescales identified. **Responsible Officer** Assistant Director – ICT Service Delivery **Due Date** March 2017 (for a complete SCC systems catalogue, a review of systems in terms of controls, put in place SCC governance of ICT systems)

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Key issues and recommendations

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

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

We will formally follow up these recommendations during the 2016/17 audit period.

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No.	Risk	Issue and recommendation	Management response/responsible officer/due date
5	3	**Old Debtor Balances** Work on debtors provisions identified that there were a large number of items being provided for that were extremely old and we would therefore expect to have been written off. Over 19,000 transactions over 3 years old were identified with a total value of almost £4m. We understand that many of these transactions have accumulated due to system limitations meaning it is very time consuming to write off old balances. **Recommendation** We recommend that the Authority utilises the opportunity presented by the implementation of a new finance ledger system to write off debts that are extremely old.	**Management Response** There is an accumulated volume of transactions with low value, which are costly and labour-intensive to write off against the bad debt provision. The implementation of the new Finance system in 2016/17~~,~~ contains new functionality to allow the debtor teams to process global write offs~~,~~ (within time, volume and value parameters still to be agreed with service managers). There are also a number of cases, which service managers have chosen not to write off at this time for service or legal reasons, overriding the age of the debt, but still providing for potential non-collection by way of a provision. **Responsible Officer** Head of Finance **Due Date** March 2017

Key issues and recommendations

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

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

We will formally follow up these recommendations during the 2016/17 audit period.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
6	3	**IT Strategy** We noted that the Council does not currently have an IT strategy in place. Without an IT strategy there is a risk that systems are weakened and the full benefits from systems that are used are not utilised. There is also a risk that systems are developed on an ad hoc basis that do not fit into a wider plan. We understand that the Council has recently drafted a Digital Strategy from which an IT strategy will be developed. **Recommendation** The Council should prioritise the development of an IT strategy in order to mitigate the risks identified above.	**Management Response** The council has been developing a digital strategy (DS), which would set out a range of objectives that would then in turn lead to the development of new IT and IT Systems Strategies. Development of the DS was delayed due to limited engagement at various times but the principles agreed by the DS Board have been incorporated into key programmes and decisions on IT strategic plans. There has been a Corporate Systems Strategy in place for some time, expected to be replaced or renewed as a result of the DS, but which recognises the federated approach outlined in the comments for Item 4. Individual portfolios have their own IT Systems Strategies, with limited visibility at a corporate level historically. Portfolios have previously indicated a wish to change this and the action above around a corporate governance for IT systems will enable us to address this in a more coherent and consistent manner. In relation to the recommendation to require our partners to hold and maintain ISA3402 for relevant systems, we will review that as part of the action below for existing systems, and also consider whether we should ensure we include it as a standard requirement for all future relevant systems procurement decisions. Action: Following the approval of the Digital Strategy (expected early Autumn 2016), develop an overarching SCC IT Strategy, encompassing also an IT Systems Strategy. Use the governance identified in Item 4 to provide an overview of the implementation of the IT Systems Strategy. **Responsible Officer** Assistant Director – ICT Service Delivery **Due Date** January 2017 (assuming DS is approved in the timescales expected and with some dependency on the Item 4 Governance point above)

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Follow up of prior year recommendations

The Authority has implemented all of the recommendations in our *ISA 260 Report 2014/15*.

This appendix summarises the progress made to implement the recommendations identified in our ISA 260 Report 2014/15 and re-iterates any recommendations still outstanding.

We are pleased to report that there are no recommendations outstanding form previous periods.

Number of recommendations that were:	
Included in original report	2
Implemented in year or superseded	2
Remain outstanding	0

Audit differences

This appendix sets out the audit differences.

The financial statements have been amended for all of the errors identified through the audit process.

There has been an impact on the General Fund of £5.31m.

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which in your case is the Audit and Standards 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.

Uncorrected audit differences

We are pleased to report that there are no uncorrected audit differences.

Corrected audit differences

Material misstatements

There were no material misstatements identified during the audit.

Non material audit differences

The following table sets out the one significant audit difference identified by our audit of Sheffield City Council's financial statements for the year ended 31 March 2016:

Impact						
No.	**Income and expenditure statement**	**Transfers to/from Earmarked Reserves**	**Assets**	**Liabilities**	**Reserves**	**Basis of audit difference**
1	Cr Taxation & Non-Specific Grant Income £5.310m	Dr Earmarked Reserves £5.310m	Dr Short Term Debtors £5.310m		Cr Earmarked Reserves £5.310m	Adjustment to reinstate the NDDR debtors balance erroneously understated leading to a corresponding impact on reserves.
	Cr £5.310m	**Dr £5.310m**	**Dr £5.310m**		**Cr £5.310m**	**Total impact of adjustments**

Additionally, a number of minor amendments focused on presentational improvements have also been made to the draft financial statements. The Finance Department remain committed to continuous improvement in the quality of the financial statements submitted for audit.

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Materiality and reporting of audit differences

For 2015/16 our materiality is £27.0 million for the Authority's accounts.

We have reported all audit differences over £1.35 million for the Authority's accounts.

Materiality

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 2015/16, presented to you in March 2016.

Materiality for the Authority's accounts was set at £27 million which equates to around 1.88 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit and Standards 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 Standards 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 £1.35 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 and Standards 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.

Requirements

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 A*udit 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 Standards 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.

Declaration of independence and objectivity (cont.)

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

General procedures to safeguard independence and objectivity

KPMG's reputation is built, in great part, upon the conduct of our professionals and their ability to deliver objective and independent advice and opinions. That integrity and objectivity underpins the work that KPMG performs and is important to the regulatory environments in which we operate. All partners and staff have an obligation to maintain the relevant level of required independence and to identify and evaluate circumstances and relationships that may impair that independence.

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

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

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

Auditor declaration

In relation to the audit of the financial statements of Sheffield City Council for the financial year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and Sheffield City Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Appendix three

Audit Independence

Audit Fees

Our scale fee for the audit was £186,998 plus VAT in 2015/16). This fee was in line with that highlighted within our audit plan agreed by the Audit and Standards Committee in March 2016. Our scale fee for certification for the HBCOUNT was £25,500 plus VAT, and fees for other grants and claims (Skills Funding Agency, Teachers Pension and Capital Pooling Allowances) totalled £12,000 plus VAT in 2015/16.

An additional fee of £7,000 plus VAT was agreed with management due to additional IT systems audit work that was required to be undertaken in year. This work was required with regards to IT systems where we were unable to rely upon any assurance from other sources. Work was carried out over the general IT controls in place across these systems to give us assurance that data produced from the systems was both secure and could be relied upon for the purposes of our audit.

Non-audit services

We can confirm we have not carried out any non-audit services in the year to 31 March 2016.

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