KPMG

External Audit DRAFT ISA260 Report 2017/18

Sheffield City Council

—

July 2018

Summary for Audit and Standards Committee

This document summarises the key findings in relation to our 2017-18 external audit at Sheffield City Council ('the Authority').

This report covers both our on-site work which was completed in March and June to July 2018 on the Authority's significant risk areas, as well as other areas of your financial statements, and the control environment in place to support the production of timely and accurate financial statements.

Organisational and IT control environment	We have identified no significant issues with the Authority's organisational and IT control environment and consider that the overall arrangements that have been put in place are reasonable.
Controls over key financial systems	The controls over the majority of the key financial systems are sound. However, there are some minor weaknesses in respect of delay in preparing bank reconciliations.
Accounts production	The Authority incorporated a number of measures into its closedown plan to further improve the project management of this complex process. Specifically, the Authority recognised the additional pressures which the earlier closedown brought and we engaged with officers in the period leading up to the year end in order to proactively address issues as they emerged.

Financial statements

Subject to all outstanding queries being resolved to our satisfaction we anticipate issuing an unqualified audit opinion on the Authority's financial statements before the deadline of 31 July 2018.

At the time of writing the below areas of work remained outstanding:

- *Review of final updated set of financial statements;*
- *Completion of final work with regards to roll forward of pension fund assets (due to late additional work requested);*
- *Finalisation of conclusions around the accounting for 'inverse' LOBO loan; and*
- *Resolution of a number of minor additional queries.*

Based upon our initial assessment of risks to the financial statements (as reporting to you in our *External Audit Plan 2017/18* and updated during our audit) we identified the following significant risks (excluding those mandated by International Standards on Auditing – see Page 11):

— **Valuation of PPE** – Whilst the Authority operates a cyclical revaluation approach, the Code requires that all land and buildings be held at fair value. In addition to work over assets revalued in year, we considered the way in which the Authority ensures that assets not subject to in-year revaluation were not materially misstated.

— **Valuation of Pensions Liabilities** – The valuation of the Authority's net pension liability, as calculated by the Actuary, is dependent upon both the accuracy and completeness of the data provided and the assumptions adopted. We reviewed the processes in place to ensure accuracy of data provided to the Actuary and considered the assumptions used in determining the valuation.

— **Faster Close** – As set out above, the timetable for the production of the financial statements has been significantly advanced with draft accounts having to be prepared by 31 May (2017: 30 June) and the final accounts signed by 31 July (2017: 30 September). We worked with the Authority in advance of our audit to understand the steps being taken to meet these deadlines and the impact on our work.

Summary for Audit and Standards Committee (cont.)

Financial Statements Cont…

Inverse LOBO Accounting – As part of our ongoing risk assessment and as a result of some clarifications made by CIPFA we further identified that there was a risk in relation to the Authority appropriately accounting for a specific 'inverse' LOBO loan held. This was due to the complexity of accounting and judgement in this area and whether the loan constituted a derivative element that ought to be accounted for separately from the underlying principal loan value.

Reporting

We have identified two audit differences (one adjusted and one unadjusted), along with a number of more minor narrative/disclosure adjustments. See page 17 for details. Those adjusted differences impact the balance sheet, but with no impact upon the net asset position. See further detail at Appendix 3.

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

We are now in the completion stage of the audit and anticipate issuing our opinion on the financial statements by 30th July 2018 with our completion certificate and Annual Audit letter to follow upon completion of our work around Whole of Government Accounts and the outstanding objection related to the 2016/17 financial statements.

Value for money arrangements

We have completed our risk-based work to consider whether in all significant respects the Authority has proper arrangements to ensure it has taken properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

We therefore anticipate issuing an unqualified value for money opinion.

We set out our assessment of those areas requiring additional risk based work in our *External Audit Plan 2017/18* and have updated this assessment during our interim visit. As a result of this we have identified the following significant VFM audit risks:

- **Identification and Delivery of Savings** – The Council identified the need for circa £40m of savings in the 2017/18 period. At Quarter 3 it was forecasting falling short of budgeted position by £5.3m. The final position was an overspend of £2m. Review of arrangements in place to monitor and deliver savings found that these were adequate; and
- **Delivery and Management of Social Care** – At Quarter 3 the People portfolio (which includes both adults and children's social care) was forecasting an overspend of £16.2m. This was thought to largely relate to demand pressures. Review of arrangements in place to monitor and best manage these pressures found the arrangements in place to be adequate.

See further details on pages 22-26.

Summary for Audit and Standards Committee (cont.)

Exercising of audit powers	We have a duty to consider whether to issue a report in the public interest about something we believe the Authority should consider, or if the public should know about. We have not identified any matters that would require us to issue a public interest report. In addition, we have not had to exercise any other audit powers under the Local Audit & Accountability Act 2014.
Acknowledgements	We would like to take this opportunity to thank officers and Members for their continuing help

Section one

Control Environment

Organisational and IT control environment

We have identified no significant issues with the Authority's organisational and IT control environment and consider that the overall arrangements that have been put in place are reasonable.

Work completed

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would have implications for our audit. We obtain an understanding of the Authority's overall control environment and determine if appropriate controls have been implemented. We do not complete detailed testing of these controls.

The Authority relies on information technology ("IT") to support both financial reporting and internal control processes. In order to satisfy ourselves that we can rely on the use of IT, we test controls over access to systems and data, system changes, system development and computer operations. This has been complemented by our own testing of the IT environment (including Academy, Integra and OHMS) and our review of phase 2 and 3 of the implementation of the new Integra ledger.

Key findings

We consider that your organisational and IT controls are effective overall.

We noted one minor observation with regards to the implementation of the new ledger. This related to the need to ensure that minutes were kept of meetings where key decisions were taken. In one instance of our testing these minutes were not available.

Aspect of controls	Assessment
Organisational controls:	
Management's philosophy and operating style	3
Culture of honesty and ethical behaviour	3
Oversight by those charged with governance	3
Risk assessment process	3
Communications	3
Monitoring of controls	3
IT controls:	
Access to systems and data	3
System changes and maintenance	3
Development of new systems and applications	3

Key	
1	Significant gaps in the control environment.
2	Deficiencies in respect of individual controls
3	Generally sound control environment.

Controls over key financial systems

The controls over the majority of the key financial systems are sound.

However, there are some weaknesses in respect of delay in preparing bank reconciliations.

We completed additional work over these at year-end to gain assurance they did not impact upon the figures disclosed in the financial statements.

Work completed

Where we have determined that this is the most efficient audit approach to take, we evaluate the design and implementation of the control and then test selected controls that address key risks within these systems. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

Our assessment of a system will not always be in line with your internal auditors' opinion on that system. This is because we are solely interested in whether our audit risks are mitigated through effective controls, i.e. whether the system is likely to produce materially reliable figures for inclusion in the financial statements.

Key findings

Based on our work we have determined that the controls over the majority of the key financial systems are sound.

We noted a weakness in respect of preparing bank reconciliations that will impact on our audit:

- Weakness 1: Due to implementation of a new finance system, Integra, and the introduction of the new Cash Management System in 2017/18 this has delayed the reconciliations being completed during the year. The reconciliations between July and December 2017 were not fully complete due to the issues stated. As the cash reconciliation is a cumulative process the team worked on getting it reconciled to January 2018 once their new staff had settled and implementation issues with the new cash management system were ironed out. Our audit work confirmed that bank reconciliations were completed and up to date from February 2018.

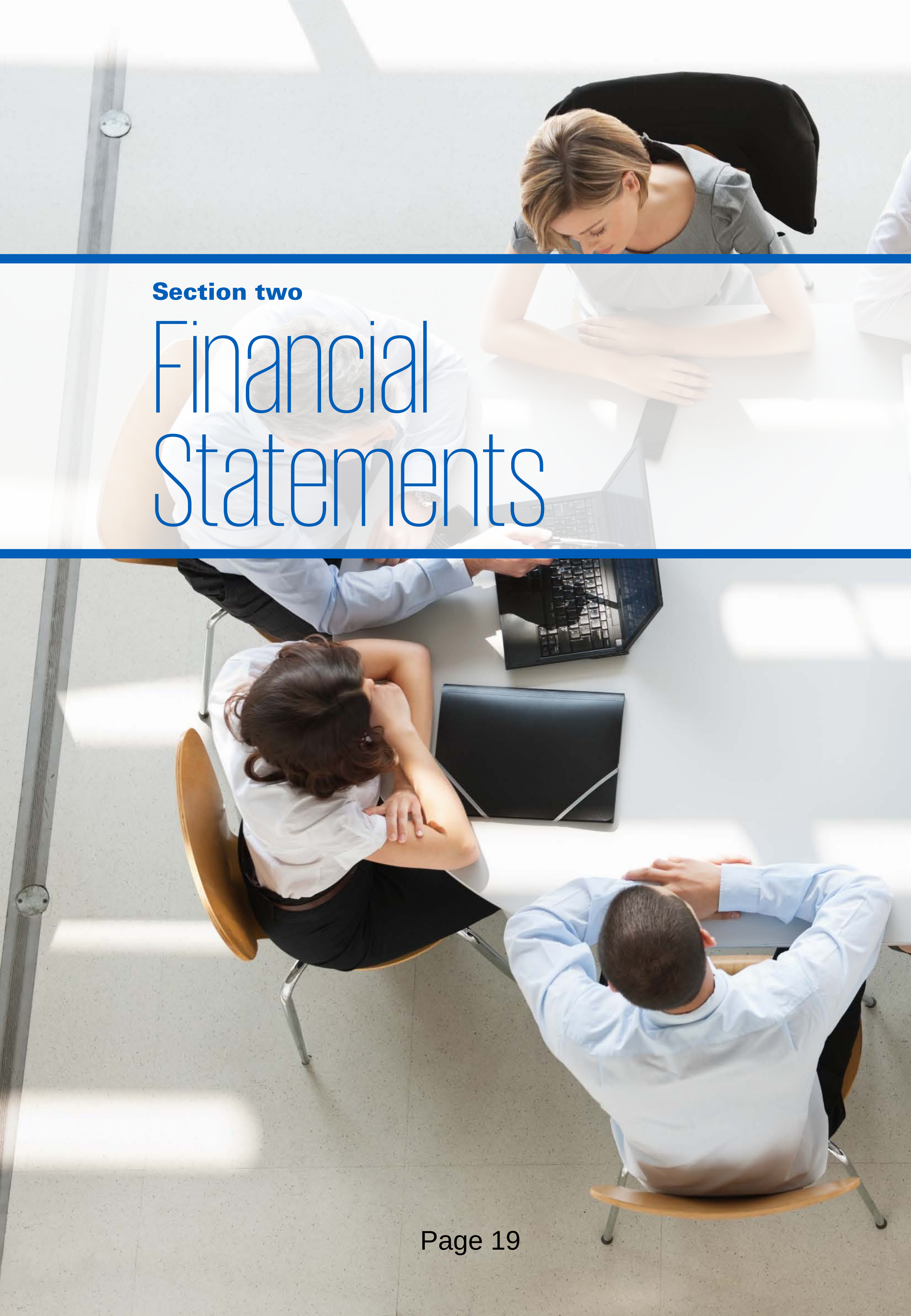
A recommendation is included in Appendix 1.

The weaknesses identified meant that we needed to complete additional substantive work at year-end.

Controls over key financial systems (cont.)

Aspect of controls	Assessment
Property, Plant and Equipment	3
Cash and Cash Equivalents	2
Pension Assets and Liabilities	3
Non pay expenditure	3
Payroll	3
Housing benefits expenditure	3
Business rates income	3
Council tax income	3
HRA rental income	3

Key	
1	Significant gaps in the control environment
2	Deficiencies in respect of individual controls
3	Generally sound control environment



Section two

Financial Statements

Accounts production and audit process

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

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

The Authority's overall process for the preparation of the financial statements is adequate.

The Authority has implemented all of the recommendations in our *ISA 260 Report 2016/17*.

Accounts practices and production process

The Authority incorporated a number of measures into its closedown plan to further improve the project management of this complex process. Specifically, the Authority recognised the additional pressures which the earlier closedown brought and we engaged with officers in the period leading up to the year end in order to proactively address issues as they emerge.

We consider that the overall process for the preparation of your financial statements is adequate.

We also consider the Authority's accounting practices appropriate.

Going concern

The financial statements of the Authority have been prepared on a going concern basis. We confirm that we have identified no significant matters which would, in our view, affect the ability of the Authority to continue as a going concern.

Implementation of recommendations

We raised nine recommendations in ISA 260 Report 2016/17. The Authority has implemented the majority of the recommendations relating to the financial statements in line with the timescales of the action plan.

The table overleaf sets out the Authority's progress against high priority recommendations. Further details are included in Appendix 2.

Accounts production and audit process (cont.)

2016/17 Issue	Progress
Impairment Review - The Council operates a five year rolling programme of valuations and thus there are a number of properties which have not been valued for a number of years, despite the Council seeing large revaluation changes over the last two years. The Council has inadequate information to demonstrate that a through impairment / valuation review has been performed to demonstrate that these assets are not materially misstated. We noted from our testing that there was a material misstatement made as a result of not fully considering recent changes in build costs and how these might impact upon the carrying value of assets held. **Recommendation -** The Council needs to ensure that it has an effective control for monitoring possible impairment of its assets. This should include developing a revaluation policy, in line with accounting standards, that considers not just the assets appropriate for revaluation but also the remaining assets for signs of impairment. This should be done by as a desktop review of the estates and through a review of corporate decision making, looking at any future changes to be made to the assets.	In 2018/19 the Council implemented a number of improvements to the impairment review. In particular regular meetings with the team in charge of capital were held to better understand the corporately approved capital programme so that it can be anticipated which assets will be subject to capital expenditure during the forthcoming financial year. Finance have also liaised with colleagues in the Capital Delivery Service and are now on the distribution list for certificates of practical completion, which act as a trigger for a revaluation during the year and movement from the assets under construction category. Finance have liaised with colleagues in Transport & Facilities Management and Building Control to ensure up-to-date information on demolition work is available. As a result of changes in build costs an index has been developed to be applied to primary, secondary and special school assets not forming part of the current year's programme to ensure the carrying amount reflects the increase in build costs. **Fully implemented.**
Rolling Programme of Valuations - The Council did not provide the audit team with adequate information available to demonstrate that the assets valued in year are proportionate to the assets held. Currently the revaluations are solely a result of a rotational revaluation policy or significant additions in year rather than informed by estates information or corporate decision making. Without a detailed analysis of the assets held and those to be revalued the Council can not be assured that it is revaluing a reflective proportion of assets each year. **Recommendation** - The Council should look to review the rolling programme of valuations to ensure there is appropriate rationale for the properties to be valued each year and that this is reflective of the full asset base.	Prior to the 2017/18 valuation programme the asset base was re-categorised to include ground rent assets whereas previously these had been categorised as offices, shops, etc. which gave a distorted view. This re-categorisation enabled the Council to provide summary tables by both IFRS category and use to confirm the percentage of assets being re-valued as part of the rolling programme in year. Where this fell below the required 20% for a particular category additional valuations from the 2018/19 programme have been brought forward to fulfil the 20% requirement by both IFRS category and use. We understand this practice will continue to be adopted to ensure the assets revalued each year are reflective of the full asset base. **Fully Implemented.**
Independence of Valuer - As the valuer is now in house, their independence needs to be clearly demonstrated. During the current year the valuation team signed off a report which had included figures in provided by finance, without a detailed review of such figures. Furthermore, the instructions do not make clear the obligations and responsibilities of both the valuation team and others in the Council. **Recommendation** - The Council needs to ensure that there are appropriate measures in place to ensure that the valuers remain independent and that these are documented through clear, detailed instructions. The valuation team should not include figures provided for other teams unless they have verified all calculations and assumptions used.	In 2017/18 an Instruction and engagement document was agreed and signed up to by both Finance and Property Services, to ensure independence by both parties. Independent checks and verifications by Property Services have now been introduced throughout the valuation process for both General Fund assets and HRA assets. **Fully Implemented**

Accounts production and audit process (cont.)

Completeness of draft accounts

We received a complete set of draft accounts on 31 May 2018, which is the statutory deadline.

Quality of supporting working papers

We issued our Accounts Audit Protocol to the Finance Manager on 14 Feb 2018. This important document sets out our audit approach and timetable. It also summarises the working papers and other evidence we require the Authority to provide to support our audit work. This helps the Authority to provide audit evidence in line with our expectations. We followed this up with a meeting with Management to discuss specific requirements of the document request list.

Specific audit areas

We anticipate issuing an unqualified audit opinion on the Authority's 2017-18 financial statements by 31 July 2018.

For the year ending 31 March 2018, the Authority has reported a surplus of £5.7m. The impact on the General Fund has been an increase of £0.942m.

Auditing standards require us to consider two standard risks for all organisations. We consider these as a matter of course in our audit and will have set out the findings arising from our work in our ISA 260 Report below.

01

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.

02

Fraudulent 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 2017-18* 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.

Over the following pages we have set out our assessment of the specific significant risks and areas of audit focus we identified in relation to the audit of the Authority's financial statements.

Specific audit areas

Significant Audit Risks – Authority

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

Risk:

Valuation of PPE

The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. In accordance with guidance from CIPFA and accepted general practice The Authority has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle.

As a result of this, however, individual assets may not be revalued for four years. An audit adjustment of £27.7m was required in the prior period in order to recognise changes in value across those assets not revalued in year. This creates a risk that the carrying value of those assets not revalued in year differs materially from the year end fair value. We also note that the Council continues to develop plans for the redevelopment of the city centre, including the Heart of the City II project. We shall consider to what extent this planned development might impact upon asset lives, valuations and possible impairments of assets held by the Council at year end.

Our assessment and work undertaken:

We reviewed the approach that the Authority adopted to assess the risk that assets not subject to valuation were materially misstated and considered the robustness of that approach.

In addition, we considered movements in market indices between revaluation dates and the year end in order to determine whether these indicate that fair values had moved materially over that time.

In relation to those assets which have been revalued during the year we reviewed the accounting entries made to record the results of the revaluation in order to ensure that they were appropriate.

We also assessed the valuer's qualifications, objectivity and independence to carry out such valuations and reviewed the methodology used (including testing the underlying data and assumptions).

As a result of this work we identified some assets that had been incorrectly recognised as additions in year on assets already subject to a revaluation. This had inflated the balance sheet value by somewhere between £3.9m and £6.75m (exact value could not be determined without full revaluation on impacted assets). Given this is below our performance materiality threshold of £14m the Authority has chosen not to amend the financial statements. Further detail is provided at Appendix 3.

No further issues of note were identified from the work performed.

We have set out our view of the assumptions used in relation to accounting for Property, Plant & Equipment at page 17.

Specific audit areas (cont.)

Significant Audit Risks – Authority (cont.)

Risk:

Pension Liabilities

The net pension liability represents a material element of the Authority's balance sheet. The Authority is an admitted body of South Yorkshire Pension Fund, which had its last triennial valuation completed as at 31 March 2016. This forms an integral basis of the valuation as at 31 March 2018.

The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Authority's overall valuation.

There are financial assumptions and demographic assumptions used in the calculation of the Authority's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should also reflect the profile of the Authority's employees, and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes.

There is a risk that the assumptions and methodology used in the valuation of the Authority's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements.

Our assessment and work undertaken:

As part of our work we reviewed the controls that the Authority has in place over the information sent to the Scheme Actuary, including the Authority's process and controls with respect to the assumptions used in the valuation. We also evaluated the competency, objectivity and independence of Mercer, the Scheme Actuary.

We reviewed the appropriateness of the key assumptions included within the valuation and compared them to expected ranges and involved a KPMG Actuary to provide a specialist assessment of those assumptions. We also reviewed the methodology applied in the valuation by Mercer, the Scheme Actuary.

In order to determine whether the net pension liability has been appropriately accounted for we also considered the valuation of pension assets. We communicated with the Pension Fund auditor (a separate KPMG team) to gain assurance over the overall value of fund assets.

Subject to the outstanding matter detailed below, as a result of this work we determined that the Authority's net pension liability had been appropriately recognised in the financial statements.

NOTE – at the time of writing there remained some outstanding final procedures with regards to the roll forward of pension fund assets, with particular regard to the increased risk around the estimation of asset values in the final quarter. This request was made relatively late in the audit and the Council are working to gather the information for this request.

We have set out our view of the assumptions used in valuing pension assets and liabilities at page 18.

Specific audit areas (cont.)

Significant Audit Risks – Authority (cont.)

Faster Close

Risk:

In prior years, the Authority has been required to prepare draft financial statements by 30 June and then final signed accounts by 30 September. For years ending on and after 31 March 2018 however, revised deadlines apply which require draft accounts by 31 May and final signed accounts by 31 July.

During 2015/16, the Authority started to prepare for these revised deadlines and advanced its own accounts production timetable so that draft accounts were ready by 31st May. In 2016/17, having also introduced a new general ledger, draft accounts were signed on 9th June. Discussions over the valuation and impairment of fixed assets, and notably the receipt of two objections, which had to be assessed for their impact on the audit opinion, meant that the final accounts were not signed until late November.

Whilst the production of draft accounts was an advancement on the timetable applied in preceding years, further work is still required in order to ensure that the statutory deadlines for 2017/18 are met.

In order to meet the revised deadlines, the Authority may need to make greater use of accounting estimates. In doing so, consideration will need to be given to ensuring that these estimates remain valid at the point of finalising the financial statements. In addition, there are a number of logistical challenges that will need to be managed. These include:

- Ensuring that any third parties involved in the production of the accounts (including valuers, actuaries, contractors) are aware of the revised deadlines and have made arrangements to provide the output of their work in accordance with this;
- Revising the closedown and accounts production timetable in order to ensure that all working papers and other supporting documentation are available at the start of the audit process;
- Ensuring that the Audit Committee meeting schedules have been updated to permit signing in July; and
- Applying a shorter paper deadline to the July meeting of the Audit Committee meeting in order to accommodate the production of the final version of the accounts and our ISA 260 report.

In the event that the above areas are not effectively managed there is a significant risk that the audit will not be completed by the 31 July deadline.

There is also an increased likelihood that the Audit Certificate (which confirms that all audit work for the year has been completed) may be issued separately at a later date if work is still ongoing in relation to the Authority's Whole of Government Accounts return and the Pension Fund Annual Report. This is not a matter of concern and is not seen as a breach of deadlines.

Our assessment and work undertaken:

We liaised with officers in preparation for our audit in order to understand the steps that the Authority was taking in order to ensure it met the revised deadlines. We also advanced audit work into the interim visit in order to streamline the year end audit work.

We received draft financial statements on the statutory deadline of 31 May 2018. The quality of this draft was consistent with that of prior years.

Where revised estimates were potentially material to the financial statements we considered the assumptions used and challenged the robustness of those estimates.

As a result of this work we determined that faster close had not had a material impact upon the financial statements.

Specific audit areas (cont.)

Significant Audit Risks – Authority (cont.)

Risk:

'Inverse' LOBO Loans

In year and as a result of queries raised by Local Government auditors nationally there was an increased focus upon the accounting for LOBO (Lender Option Borrower Option) loans, and in particular those known as 'inverse' LOBOs where the interest rate charged may act inversely to an outside measure (e.g. LIBOR or Ten Year Swap Rates).

We were already aware of the existence of a number of LOBO loans at the Authority and therefore there was a risk that, in the cases of inverse LOBOs in particular, these had not been accounted for appropriately. Unless certain criteria are met there is a possibility that any separable derivative element of the loan should be accounted for separately. Were it to be accounted for separately the movement in fair value would be taken through the Authority's CIES account and impact upon the General Fund.

There is a risk that the Authority does not appropriately identify where a derivative may be separable within a LOBO loan, resulting in an incorrect accounting treatment.

Our assessment and work undertaken:

We liaised with officers with regards to the new guidance/thought leadership around LOBO loans.

We have reviewed the LOBO loans in place at the Council and confirmed one loan which was 'inverse' in nature.

We have reviewed and corroborated the reasoning from the Council's treasury management advisers as to why there was no change required to the current and historic accounting treatment with regards to this loan.

We have agreed supporting underlying information to both the loan agreement itself and the requirements of IFRS 9 and IAS39.

We are awaiting confirmation of the final technical review of our work in this area, but currently anticipate that no change will be required to how the LOBO loan has been accounted for.

Judgements

We have considered the level of prudence within key judgements in your 2017-18 financial statements and accounting estimates. We have set out our view below across the following range of judgements.

Level of prudence

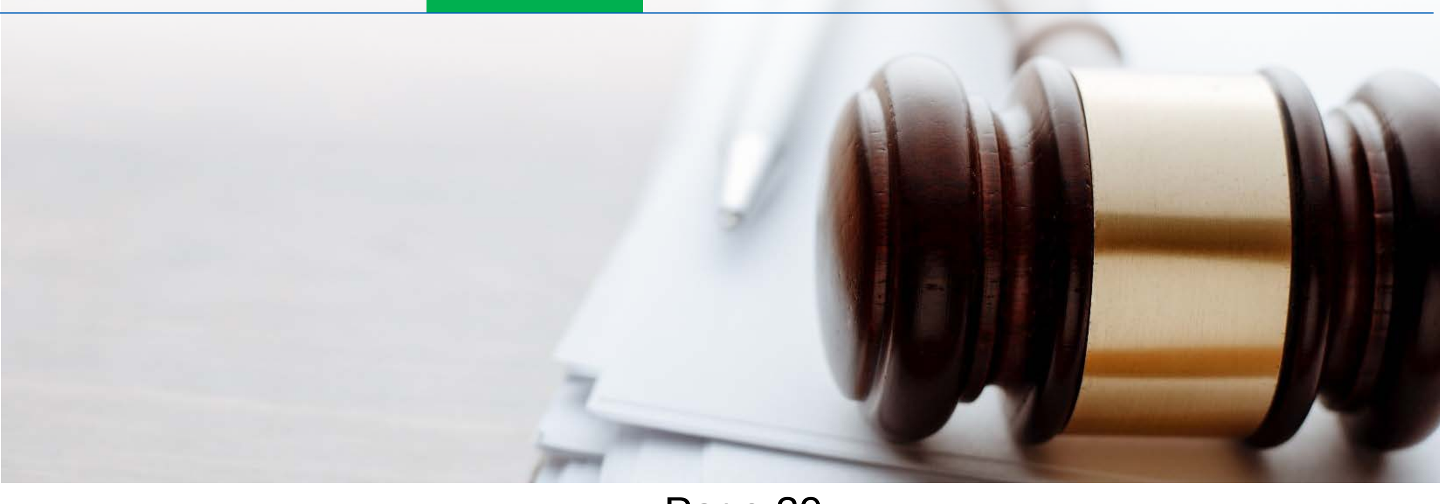
0	1	2	3	4	5	6
Audit Difference	Cautious		Balanced		Optimistic	**Audit Difference**
	Acceptable Range					

Subjective area	2017-18	2016-17	Commentary
Provisions (excluding Business Rates)	2	2	We have reviewed the assumptions and judgements which underpin the £17.4m of provisions highlighted in Note 28 of the accounts and we are satisfied that there is no risk of material misstatement in light of the assumptions used.
Business Rates provision	4	3	Since 2013/14 the Authority has been responsible for a proportion of successful rateable value appeals. The NNDR provisions held at year end (£17.1m) are significantly less than our materiality level of £20m. We have reviewed the workings for the NNDR provisions and note that these have increased from the prior period based on the additional provisions in the year. The methodology behind this calculation is considered balanced and based accordingly upon recent historical trends and knowledge of current cases.
Property Plant & Equipment: HRA Assets	3	3	The Authority continues its use of the beacon methodology in line with the DCLG's *Stock Valuation for Resource Accounting* published in November 2016. The Authority has utilised its in house valuation team to provide valuation estimates. We have reviewed the instructions provided and deem that the valuation exercise is in line with the instructions. We have also assessed the valuation against local House Price Index movements, including reviewing indices applied to those assets not subject to a full valuation exercise in year.
Property Plant & Equipment: Other Land Buildings	3	0	The Authority has made significant strides in the current year in ensuring its valuation approach and considerations were wide-ranging. This included consideration of any movements in build costs and other indices that might indicate a wider impact upon overall valuation of the assets held. We have reviewed the workings and methodology behind valuation assessments, as well as sample testing a number of individual valuations to directly test the underlying assumptions. We have also tested a sample of additions and disposals accounted for in the year. One error was identified with regards to a recognition of additions on assets already revalued, however this was due to a minor flaw in process rather than reflective of an incorrect judgement. We note that this error was not material and therefore assess that a balanced approach had been taken.

Judgements (cont.)

Subjective area	2017-18	2016-17	Commentary
Valuation of pension assets and liabilities	3	3	The Authority continues to use Mercer to provide actuarial valuations in relation to the assets and liabilities recognised as a result of participation in the Local Government Pension Scheme. Due to the overall value of the pension assets and liabilities, small movements in the assumptions can have a significant impact on the overall valuation. NOTE – at the time of writing we were awaiting further detail as to the level of estimation within the pension assets valuation due to estimated returns in the final quarter. The actual assumptions adopted by the actuary fell within our expected ranges as set our below:

Assumption	Actuary Value	KPMG Range	Assessment
Discount rate	2.60%	2.20-2.60%	5
Pension Increase Rate	2.20%	1.90-2.50%	3
Salary Growth	1.25% until 31 March 2020, CPI plus 1.25% thereafter	CPI plus 0% to 2.0%	3
Life expectancy Males currently aged 45 / 65 Females currently aged 45 / 65	 25.2/ 23.0 28.1/25.8	 23.5/22.1 25.4/23.9	1



Proposed opinion and audit differences

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's 2017-18 financial statements following approval of the Statement of Accounts by the Audit and Standards Committee on 26 July 2018.

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 4) for this year's audit was set at £20 million. Audit differences below £1 million are not considered significant.

Our audit identified a total of two significant audit differences, which we set out in Appendix 3. The first of these (related to debtor, cash and creditor balances) has been adjusted in the final version of the financial statements. The second adjustment related to fixed asset additions will not be adjusted.

There has been no impact upon net assets held or the General Fund as a result of the adjusted audit differences. Had the adjustment been made to the Property, Plant and Equipment balances, this would have reduced the net asset position with a corresponding impact upon the Council's surplus/deficit position although due to the Capital nature of these items there would not have been an impact upon the General Fund.

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 2017-18 ('the Code') and also to correct minor disclosure/narrative errors. We have set out details of significant presentational adjustments in Appendix 3. The Authority has addressed these where significant.

Proposed opinion and audit differences (cont.)

Annual governance statement

We have reviewed the Authority's 2017-18 Annual Governance Statement and confirmed that:

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

We have made a number of comments in respect of its format and content which the Authority has agreed to amend where significant.

Narrative report

We have reviewed the Authority's 2017-18 narrative report and have confirmed that it is consistent with the financial statements and our understanding of the Authority.

Annual report

We have reviewed the Authority's 2017-8 Annual Report and can confirm it is not inconsistent with the financial information contained in the audited financial statements.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's 2017/18 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 2018, 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 6 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 Responsible Finance Officer for presentation to the Audit and Standards Committee. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

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

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

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority's 2017-18 financial statements.

Section three

Value for Money Arrangements

Specific value for money risk areas

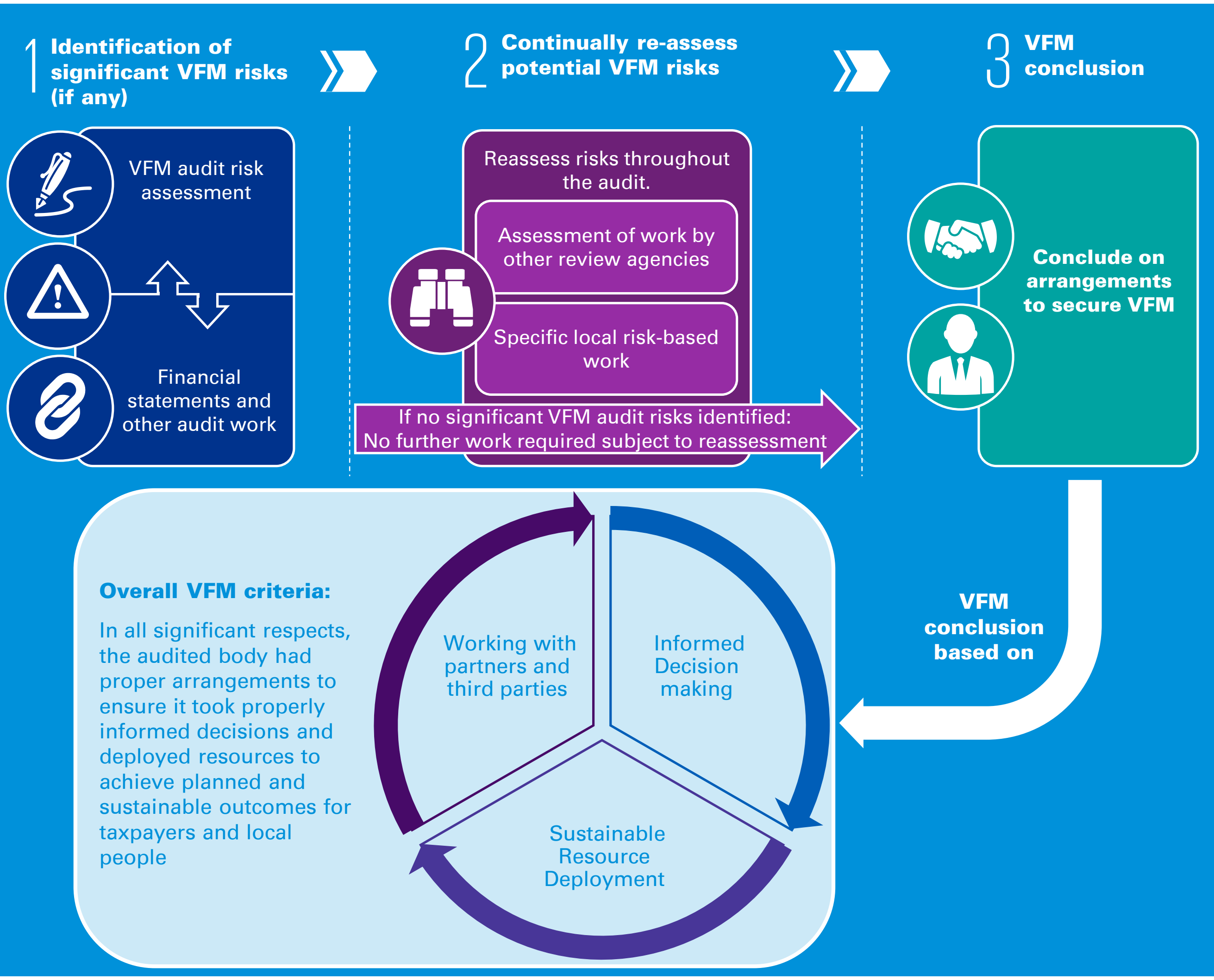
Our 2017-18 VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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

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.'

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



Specific value for money risk areas (cont.)

The table below summarises our assessment of the individual VFM risks identified against the three sub-criteria. This directly feeds into the overall VFM criteria and our value for money opinion.

Applicability of VFM Risks to VFM sub-criteria			
VFM Risk	**Informed decision making**	**Sustainable resource deployment**	**Working with partner and third parties**
Identification and Delivery of Savings	✓	✓	✓
Delivery and Management of Social Care	✓	✓	✓

In consideration of the above, we have concluded that in 2017-18, 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.

Our work identified the following areas of weakness in the Authority's arrangement:

— We note that there is currently some uncertainty with regards to the Authority's future budgets and funding requirements, largely as a result of a lack of clarity around future salary inflation and requirements.

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

Specific value for money risk areas (cont.)

As communicated to you in our *External Audit Plan 2017-18*, and as updated throughout the audit, we have identified two risks requiring specific audit attention and procedures to address the likelihood that proper arrangements are not in place to deliver value for money.

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.

We have provided below a summary of the risk areas identified, our work undertaken and the conclusions reached.

Risk:

Identification and Delivery of Savings

The Authority identified the need to make significant savings of £40m in 2017/18. The Quarter 3 position showed a forecast overspend of approximately £5.3 million. There is therefore a risk that the Authority does not find required budget savings in the final quarter to meet the approved balanced budget. We note that to date, a significant proportion of the saving made has been due to the underspend and reallocation of Corporate resources. Moving forward, in the 2018/19 budget (approved in February 2018) it was recognised that circa £31m of additional savings were required, with these predominantly occurring with regards to Social Care delivered by the People portfolio (£22.2m) (see separate risk identified below). The approved budget includes individual proposals to support the delivery of the overall savings requirement. It is anticipated that further savings will be required beyond 2018/19 to principally address future reductions to local authority funding alongside service cost and demand pressures. As a result, the need for savings will continue to have a significant impact on the Authority's financial resilience.

Our assessment and work undertaken:

Like most of local government, the Authority faces a challenging future driven by funding reductions and an increase in demand for services, in particular with regards to Social Services.

The Authority overspent its General Fund budget in year by £2m. Total overspends attributable to Social Care costs were circa £17.9m and clearly had a large impact on the overall financial performance of the Council.

We noted through our work that the financial position of the Authority had been transparently reported and monitored throughout the period, enabling both officers and members to make informed decisions.

As part of our work we have considered the Authority's most recent medium term financial plan (July 2017) as well as discussed with management the draft revised Medium Term Financial Plan due for approval shortly. We noted that the plan had taken due account of issues such as funding reductions, salary and general inflation, demand pressures, restructuring costs and sensitivity analysis given the degree of variability in the above factors. Consideration has also been made with regards to the pressures facing individual portfolios and services.

We noted from conversation with management that there remained some significant uncertainty with regards to future pay awards that if left unaddressed could have a negative impact upon the ability of the Authority to make appropriate future financial plans.

However, overall we were satisfied that the Authority had in place proper arrangements to ensure it took properly-informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Specific value for money risk areas (cont.)

Significant VFM Risks (cont.)

Risk:

Delivery and Management of Social Care

As noted in the risk identified around financial resilience, much of the cost pressures on the Council are occurring within Social Care (both Adults and Children's) both as a result of demand pressures and some delays in delivering planned savings. We note that at Quarter 3 the People portfolio was forecasting an overspend of £16.2m. In the 2018/19 budget £22.2m of the £31m of savings identified are related to the People portfolio. We recognise that pressures around social care, including significant demand pressures, are an issue nationally. However, the combination of a pressured service, forecast overspend to budget, delays in implementing some planned savings and the large number of interactions with other organisations, that delivery of successful social care arrangements is reliant upon, means we have identified this as a significant risk in the year.

Our assessment and work undertaken:

As part of our risk based work, we have reviewed reports and monitoring of budgets and cost controls. In particular we have reviewed the financial performance and contract management in relation to Social Care.

We assessed the Council's processes for reviewing the performance of these services and whether there were appropriate methods for managing and monitoring performance in year, including the relevant reporting of this to management and members. We also reviewed how the Authority is working with partners and third parties to deliver social care.

Our work noted that there were a number of monitoring actions and processes in place, including regular financial reporting, review, monthly improvement and recovery Boards and other regular meetings.

In addition, we noted that individual cost saving schemes and monitoring of pressures were in place, including the consideration of costs if individual placements and how demand pressures could be best managed.

We also noted the example of Mental Health, where partnership working had enabled a risk/gain sharing arrangement to be put into place with the local CCG. This was in addition to a number of regular interactions and working with other third parties.

Social Care services were attributed with an overspend of £17.9m in year. However, we noted that this was largely due to demand pressures, many of which were outside of the direct control of the Authority. We also noted that the financial position was transparently reported throughout the year and the Authority had been proactive in looking to implement change and an improved position. We also note from 2016/17 data that the Authority is in line with others in the area and nationally with regards to the level of spending on Social Care.

Overall, we were provided with evidence that demonstrated that the Authority had worked with third parties, transparently reported and proactively monitored and managed social care services in the year. This had enabled informed decisions to be made and resources to be deployed as sustainably as could reasonably be expected.

Appendices

Appendix 1:

Key issues and recommendations

Our audit work on the Authority's 2017-18 financial statements and Value For Money arrangements has identified a number of 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.

The Authority should closely monitor progress in addressing the risks, including the implementation of our recommendations.

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

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. Recommendations Raised: 0	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. Recommendations Raised: 3	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. Recommendations Raised: 2

No.	Risk	Issue & Recommendation	Management Response
1	2	**Fixed Assets – Review of additions** ***Risk*** Our audit work identified that a number of additions (largely maintenance work to schools) had been capitalised. However, as part of the reassessment of the valuation of the assets these additions should have already been taken account of. There was therefore an overstatement in the value of assets held. We recognise that this error occurred largely due to changes in the valuation processes, as well as some of the time pressures caused by the shortened statutory reporting deadlines. ***Recommendation*** The Authority should implement a further review process into the valuation assessment to ensure that asset additions on those properties subject to a Depreciated Replacement Cost valuation methodology are accounted for appropriately.	The Financial Accounts team will continue to make improvements to the process of accounting for fixed assets. This recommendation will be actioned in 2018/19 and will form part of the chain of actions required for the closure of capital and will also form part of the year end capital process / guidance notes to assist the team in the future. ***Responsible Officer*** Head of Strategic Finance ***Implementation Deadline*** March 2019

Appendix 1:

Key issues and recommendations

No.	Risk	Issue & Recommendation	Management Response
2	2	**Debtors / Cash posting** ***Risk*** Our audit work raised two queries with regards to balances on debtors and cash. The finance team confirmed that some differences had been identified by themselves with regards to the cash and debtors balances. These were largely a result of cash postings / income allocation not having been performed prior to ledger close at the year end. This issue is thought to partly stem from the use of inexperienced agency staff, although management are currently working to fully understand any underlying issues. We note that the posting and allocation of income can be a complex, time consuming exercise. Where such postings are not kept up to date or appropriately reviewed there is an increased risk of error. In turn this can lead to difficulties in unwinding or understanding any previous errors or delays in posting. ***Recommendation*** The Council should continue to seek to understand the underlying issues that led to the identified error. In particular the year end processes should be amended to ensure all relevant postings are made and fully reviewed prior to ledger close down. The Authority may also wish to consider whether adequate, experienced resource is available to address any underlying failings.	The Control team have put in place immediate actions to rectify the issues identified at year end. The Control team will continue to work closely with both the ICAM and Treasury teams during 2018/19. In preparation for the close of 2018/19 both the Closedown Timetable and the Closedown Guidance pack will be updated and communicated with the relevant officers to ensure all systems and ledgers are closed down appropriately and officers are fully trained in these areas. ***Responsible Officer*** Head of Strategic Finance ***Implementation Deadline*** March 2019
3	2	**VFM – finalising pay awards** ***Risk*** We noted from our audit work and discussions with Senior Officers that there was currently some uncertainty with regards to the level and structure of future pay awards. Without further clarity around such issues it may make it more difficult moving forwards for the Council to make appropriate medium to long term financial plans. ***Recommendation*** The Council should seek to clarify and finalise plans around future pay awards in order to ensure appropriate medium to long term financial planning can take place.	Detailed national guidance has been prepared for councils regarding the implementation of the national pay award in 2018/19 and 2019/20, which SCC will follow. Work on the financial impact and discussions with the Trade Unions are on-going. ***Responsible Officer*** Head of HR and Customer Services ***Implementation Deadline*** March 2019

Key issues and recommendations

No.	Risk	Issue & Recommendation	Management Response
4	3	**Preparation of Bank Reconciliations** ***Risk*** Due to implementation of a new finance system, Integra, and the introduction of the new Cash Management System in 2017/18 this has prevented bank reconciliations being completed during the year. The reconciliations between July and December 2017 were not fully complete due to the issues stated. We noted from our audit work that reconciliations had been carried out from January to March. Wherever key controls are not operating as intended there is an increased risk of error. ***Recommendation*** As part of any future changes to key financial systems the Council should consider the impacts upon the control environment and the capacity of existing resource to maintain the control environment effectively.	Bank reconciliations had been fully completed for the final quarter of 2017/18 and bank reconciliations have since continued to be fully completed on a monthly basis in 2018/19. The Council will note this recommendation as part of any future changes to key financial systems. ***Responsible Officer*** Head of Strategic Finance ***Implementation Deadline*** March 2019
5	3	**LOBO Interest Rate Floor and Cap** ***Risk*** Our work with regards to the 'inverse' LOBO held by the Council found that there was no contractual floor (i.e. minimal interest rate) formally written into the loan agreement. With regards to an inverse LOBO the ability (however remote) for a loan to move to a negative interest rate can have significant consequences for the subsequent accounting treatment of such loans. With regards to our audit we were able to gain assurance from a separate communication with the bank confirming both the floor (i.e. minimum) interest rate of 0% and the capped (i.e. maximum) interest rate of 8.75%. ***Recommendation*** We would recommend that a review of all loan agreements is undertaken in order to confirm that the intended operation (including range of interest rates) of each loan is contractually confirmed. In the instance of the 'inverse' LOBO loan we would recommend the Authority requests a change to the current loan agreement reflecting the operational interest rates as confirmed separately by the bank.	The Council will consider this recommendation and will review all current LOBO loan agreements to look to ensure the intended operation (including range of interest rates) of each loan is contractually confirmed. This will obviously be dependent upon the third party agreeing to such contractual amendments and the support and assistance of our Legal team. ***Responsible Officer*** Head of Strategic Finance ***Implementation Deadline*** March 2019

Appendix 2:

Follow-up of prior year recommendations

The Authority has not yet fully implemented all of the recommendations raised through our previous audit work.

We re-iterate the importance of the outstanding recommendations and recommend that these are implemented as a matter of urgency.

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2016/17* and outstanding recommendations from previous audit years and re-iterates any recommendations still outstanding.

Number of recommendations that were	
Included in the original report and outstanding from previous years	12
Implemented in year or superseded	10
Outstanding at the time of our final audit	2

No	Risk	Issue & Recommendation	Management Response	Updated response as at 31 March 2018
1	2	Revoke Leaver IT Access ***Risk*** Within the Integra system there were found to be 39 active accounts assigned to individuals who had left employment with the Council. In many cases this was due to backlogs within the HR/FSSG process but we noted two cases where accounts for individuals who had left the council in 2009 and 2013 had incorrectly been migrated from OEO. We confirmed that none of these accounts had been used after the stated leaving date. ***Recommendation*** The Council should implement a periodic review of all user access to systems and confirm this remains appropriate for the individuals role.	We have now deleted these accounts. We will consider your suggestion to undertake a reconciliation of current employees to the Integra users, but at the present time this would be a huge task to undertake for the team. The FSSG team have said however, that there is potential for them to carry out this task once phases 2 and 3 have gone live and the resource is available. ***Responsible Officer*** Head of Strategic Finance ***Implementation Deadline*** March 2018	The Integra Password expires after 60 days, following which the user is unable to log in if they have allowed their password to expire. So this control mitigates risk to an extent. As an additional action, FSSG will run a report identifying users who haven't logged on for a set number of days (90 of inactivity) and will then contact the user, and delete roles as required for users who no longer require access/have left and FSSG haven't been informed. For users who are on extended/maternity leave, we will leave their access disabled but roles intact for when they return. **Partially Implemented.**

Follow-up of prior year recommendations (cont.)

No.	Risk	Issue & Recommendation	Management Response	Status as at 31 March 2018
2	2	IT System Assurance ***Risk*** 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.	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 ***Implementation Deadline*** March 2017 (for a complete SCC systems catalogue, a review of systems in terms of controls, put in place SCC governance of ICT systems)	The Council as part of delivering the new ICT Strategy, are to terminate the ICT contract with Capita and take ownership back of all ICT delivery. This will involve a mixture of direct delivery and recommissioning. This will involve the establishment of a new ICT function with a clearly defined RACI for all systems. Some work has already been done on this and will be finalised as part of the transition of ICT services and applications back to the Council. Notice to terminate has already been given to Capita and the current plan is to have services transition between now and the end of the financial year (31st March 2019). The intention is that the Council will manage all applications internally and this is planned to be in place no later than March 2019. **Partially Implemented.**

Appendix 3:

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 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.

A number of minor amendments focused on presentational improvements have also been made to the 2017-18 draft financial statements. The Finance team is committed to continuous improvement in the quality of the financial statements submitted for audit in future years.

Adjusted audit differences

The following table sets out the significant adjusted audit differences identified by our audit of Sheffield City Council's financial statements for the year ended 31 March 2018. These amounts have been corrected.

Table 1: Adjusted audit differences – Authority (£'000)

No.	Income and expenditure statement	Assets	Liabilities	Basis of audit difference
1		Cr Short Term Debtors – Other entities & Individuals £4,186	Dr Short Term Creditors – Other entities & individuals £1,394	A number of postings to recognise income received had not been made prior to the year end, resulting in an error in debtors, creditors and cash balances. Net impact on the balance sheet and CIES position is nil.
			Dr Cash & Cash Equivalents £2,792	
		Cr £4,186	**Dr £4,186**	**Total impact of adjustments**

Unadjusted audit differences

There is 1 unadjusted audit difference to report:

Table 2: Unadjusted audit differences – Authority (£'000)

No.	Income and expenditure statement	Assets	Liabilities	Basis of audit difference
1	Dr Surplus on revaluation of Non Current Assets £3,909	Cr Property, Plant & Equipment £3,909		The Council had capitalised a number of items in the year, not having taken account of the fact that these had also been subject to a separate valuation exercise. The value of this difference sits between £3,909k and £6,752, however without revaluing the assets in question we are unable to more accurately quantify the error.
	Dr £3,909	**Cr £3,909**		**Total impact of adjustments**

Audit differences (cont.)

Presentational adjustments - Authority

We identified a number of presentational adjustments required to ensure that the Authority's financial statements for the year ending 31 March 2018 are fully compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2017-18 ('the Code').

Whilst the majority of these adjustments were not significant, we identified a limited number of adjustments of a more significant nature and details of these are provided in the following table.

We understand that these have been adjusted and we are finalising our review of the final set of financial statements to confirm this.

Table 3: Presentational adjustments

No.	Basis of audit difference
1	Collection Fund – note 2 NNDR disclosure No reference to the standard business rate multiplier in the wording. Assumes all business rates are multiplied by the small business rate multiplier (0.466)
2	£13.9k of audit fees relating to grants work to be moved from fee payable for external audit services line to fees payable for certification of grant claims and returns.
3	A number of 'Other' balances were requested to be reviewed / changed as it was felt these were not disaggregated far enough to demonstrate compliance with the Code. These have been updated where considered material.
4	Some minor narrative errors to the pensions note as a result of not updating prior period figures.
5	Annual Governance Statement – Some small amounts of additional detail were required to fully meet the requirements of the Code.
6	A small number of minor casting/consistency errors as a result of roundings.

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 2017-18*, presented to you in March 2018.

Materiality for the Authority's accounts was set at £20 million which equates to around 1.53 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, an individual difference is considered to be clearly trivial if it is less than £1 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.

Appendix 5:

Required communications with the Audit and Standards Committee

We have provided below at-a-glance summary of the information we are required to report to you in writing by International Accounting Standards.

Required Communication	Commentary
Our draft management representation letter	We have requested one specific representations in addition to those areas normally covered by our standard representation letter for the year ended 31 March 2018. This specific representation is in relation to the value of the debtor held by the Authority related to Major Sporting Facilities assets due to transfer to the Authority in 2024.
Adjusted audit differences	We have identified one adjusted audit difference with a total value of £4.186 million. See page 33 for details. This adjustment has resulted in a nil net impact upon the Balance Sheet or recorded surplus.
Unadjusted audit differences	We have identified one unadjusted audit difference with a total value of between £3.909 and £6.752 million. See page 33 for details. This difference would have resulted in a reduction in the net asset value and impacted upon the reported Surplus although there would have been nil impact upon the General Fund.
Related parties	There were no significant matters that arose during the audit in connection with the entity's related parties.
Other matters warranting attention by the Audit and Standards Committee	There were no matters to report arising from the audit that, in our professional judgment, are significant to the oversight of the financial reporting process.
Control deficiencies	We have set out our assessment of the Authority's internal control environment, including details of any deficiencies identified, in Section one of this report (see pages 5 to 6). We communicated to management in writing all deficiencies in internal control over financial reporting of a lesser magnitude than significant deficiencies identified during the audit that had not previously been communicated in writing.
Actual or suspected fraud, noncompliance with laws or regulations or illegal acts	We identified no actual or suspected fraud involving the Authority's Member or officers with significant roles in internal control, or where the fraud resulted in a material misstatement in the financial statements.
Significant difficulties	No significant difficulties were encountered during the audit.
Modifications to auditor's report	There are no modifications to our audit report.
Disagreements with management or scope limitations	The engagement team had no disagreements with management and no scope limitations were imposed by management during the audit.

Appendix 5:

Required communications with the Audit and Standards Committee (cont.)

Required Communication	Commentary
Other information	No material inconsistencies were identified related to other information in the Narrative Report or Annual Governance Statement. These reports were found to be fair, balanced and comprehensive, and compliant with applicable requirements.
Our declaration of independence and any breaches of independence	No matters to report. The engagement team and others in the firm have complied with relevant ethical requirements regarding independence. See Appendix 6 for further details.
Accounting practices	Over the course of our audit, we have evaluated the appropriateness of the Authority's accounting policies, accounting estimates and financial statement disclosures. In general, we believe these are appropriate. We have set out our view of the assumptions used in valuing pension assets and liabilities at page 16.
Significant matters discussed or subject to correspondence with management	There were no significant matters arising from the audit which were discussed, or subject to correspondence, with management.

Declaration of independence

ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF Sheffield City Council

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

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code of Audit Practice, the provisions of Public Sector Audit Appointments Limited's ('PSAA's') Terms of Appointment relating to independence, the requirements of the FRC Ethical Standard and the requirements of Auditor Guidance Note 1 - General Guidance Supporting Local Audit (AGN01) issued by the National Audit Office ('NAO') on behalf of the Comptroller and Auditor General.

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

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

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP partners, Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. As a result we have underlying safeguards in place to maintain independence through:

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

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

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

Declaration of independence (cont.)

Independence and objectivity considerations relating to the provision of non-audit services

Summary of fees

We have considered the fees charged by us to the authority and its controlled entities for professional services provided by us during the reporting period. We have detailed the fees charged by us to the authority and its controlled entities for significant professional services provided by us during the reporting period in Appendix 7, as well as the amounts of any future services which have been contracted or where a written proposal has been submitted. Total fees charged by us for the period ended 31 March 2018 can be analysed as follows:

	2017-18 £	2016-17 £
Audit of the Authority	190,998	195,998
Total audit services	**190,998**	**195,998**
Audit related assurance services	12,000	12,000
Mandatory assurance services	30,025	23,262
Total Non Audit Services	**42,025**	**35,262**

We are required by AGN 01 to limit the proportion of fees charged for non-audit services (excluding mandatory assurance services) to 70% of the total fee for all audit work carried out in respect of the Authority under the Code of Audit Practice for the year. We do not consider that the total of non-audit fees creates a self-interest threat since the absolute level of fees is not significant to our firm as a whole.

Other than non-PSAA grants (as outlined in further detail overleaf) we can confirm we have not carried out any further non-audit services.

Facts and matters related to the provision of non-audit services and the safeguards put in place that bear upon our independence and objectivity, are set out in the table on the following page.

We also note that there were 2 objections to the 2016/17 accounts, for which additional work has been completed, and in the case of 1 objection remains ongoing. These additional pieces of work will be subject to further fees to be agreed with management and PSAA.

Declaration of independence (cont.)

Analysis of Non-audit services for the year ended 31 March 2018

Description of scope of services	Principal threats to independence and Safeguards applied	Basis of fee	Value of services delivered in the year ended 31 March 2018 £	Value of services committed but not yet delivered £
Audit-related assurance services				
Pooling Capital Receipt Return	Self-Review. Work performed following main financial statements audit work. Work is of small value compared to main audit work (<2% of total audit fee).	Fixed Fee	2,750	2,750
Teacher's Pensions Agency Return	Self-Review. Work performed following main financial statements audit work. Work is of small value compared to main audit work (<2% of total audit fee).	Fixed Fee	3,250	3,250
SFA Subcontractor Controls Assurance	Self-Review. Work performed following main financial statements audit work. Work is of small value compared to main audit work (<4% of total audit fee).	Fixed Fee	6,000	6,000
Mandatory assurance services				
Grant Certification – Housing Benefit Subsidy Return	Self-Review. Mandatory work performed under the PSAA regime following main financial statements audit work. Work is of small value compared to main audit work (<4% of total audit fee).	Fixed Fee	23,262	30,025

Declaration of independence (cont.)

Appropriate approvals have been obtained from PSAA for all non-audit services above the relevant thresholds provided by us during the reporting period.

Independence and objectivity considerations relating to other matters

We set out below our consideration of other matters which, in our professional judgement, have a bearing on our independence and objectivity.

Former employees of KPMG employed by the authority

The following former employee, who has left in the past 4 years, is now employed at Sheffield City Council

The 'Head of Strategic Finance' was a previous senior manager at KPMG. This was consulted on in 2014/15 where the relationship changed. The employee left KPMG on 07.01.2015.

Our findings at consultation in January 2015 found the following:

We do not believe that this impairs our independence as the employee in question was only with KPMG for a relatively short period (2 years). The employee had never worked with the managers on the audit (manager and senior manager). The manager on the audit was not working for KPMG during a large proportion of the employees time and never worked together. The senior manager returned in October 2012 from a 12 month client secondment and then went on maternity leave from December 2012-February 2014, then going on maternity leave again from August 2014 - demonstrating that the employee and the senior manager were only engaged in KPMG for a short period and never actually worked on any of the same jobs. The employee was based in a different office to the Responsible Individual (RI). Additionally, the RI is aware of, and monitors, the situation. Therefore, it is not considered that this relationship is a threat to our independence of the client.

Overdue fees

There were no overdue fees at the time of writing this report.

Confirmation of audit independence

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

This report is intended solely for the information of the Audit and Standards Committee of the authority and should not be used for any other purposes.

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

KPMG LLP

KPMG LLP

Appendix 7:

Audit fees

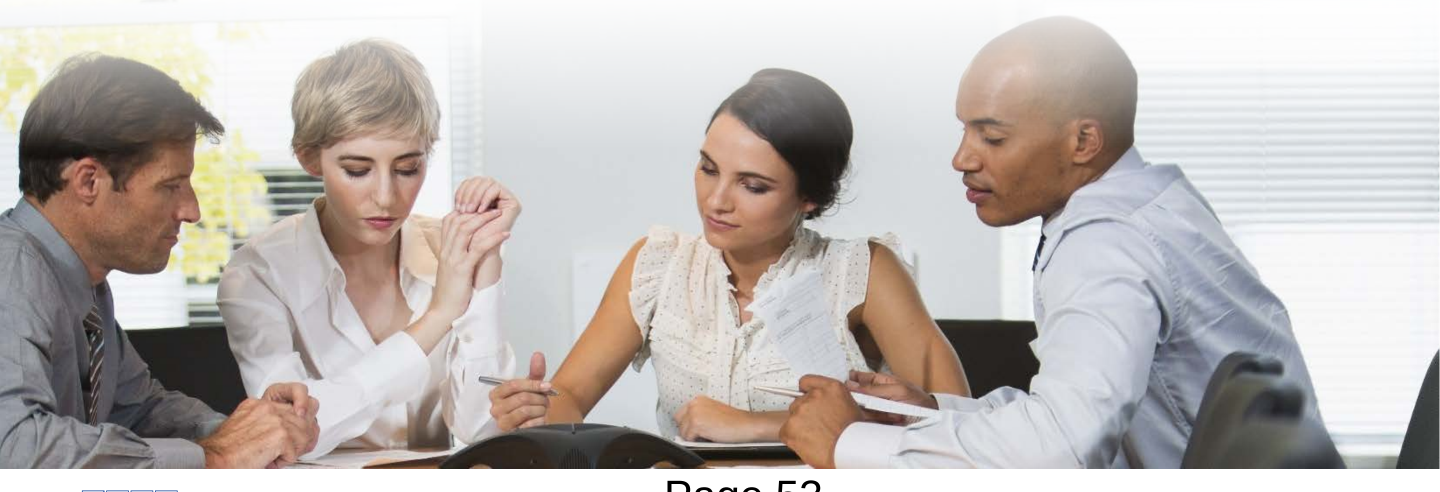
As communicated to you in our *External Audit Plan 2017-18*, our scale fee for the audit is £186,998 plus VAT (£186,998 in 2016/17), which is consistent with an increase of 2% from the prior year.

We have previously agreed with management an additional fee of £4,000 related to additional work required over phases 2 and 3 of the new Integra General Ledger system. This additional fee remains subject to PSAA approval.

Our work on the certification of the Authority’s Housing Benefit Subsidy return is not yet complete. The planned scale fee for this is £30,025 plus VAT (£19,840 in 2016/17). Planned fees for other grants and claims which do not fall under the PSAA arrangements amount to £12,000 plus VAT (£12,000 in 2016/17), see further details below.

Component of the audit	2017-18 Planned Fee £	2016-17 Actual Fee £
Accounts opinion and value for money work		
PSAA Scale fee (Sheffield City Council)	186,998	186,998
Additional fee in relation to IT	4,000	9,000
Total audit services	**190,998**	**195,998**
Mandatory assurance services		
Housing Benefits Certification	30,025	23,262
Total mandatory assurance services	**30,025**	**23,262**
Audit-related assurance services		
Teachers’ Pension Return	3,250	3,250
Pooling of Housing Capital Receipts	2,750	2,750
SFA Subcontractor Controls Assurance	6,000	6,000
Total audit-related assurance services	**12,000**	**12,000**
Total non-audit services	**42,025**	**35,262**
Grand total fees for the Authority	**233,023**	**231,260**

All fees quoted are exclusive of VAT.



The key contacts in relation to our audit are:

Tim Cutler
Partner

T: +44 161 2464774
E: tim.cutler@kpmg.co.uk

Matthew Ackroyd
Manager

T: +44 113 2542996
E: Matthew.Ackroyd@kpmg.co.uk

Sarah Bafarea
Assistant Manager

T: +44 7775817861
E: Sarah.Bafarea@kpmg.co.uk

kpmg.com/uk