KPMG

Perth and Kinross Council

Interim management report and audit status summary

For the year ended 31 March 2018

For Audit Committee consideration on 23 May 2018

Contents

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If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Andy Shaw, who is the engagement leader for our services to the Council, telephone 0131 527 6673 email: andrew.shaw@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Hugh Harvie, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6682 or email to hugh.harvie@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Fiona Kordiak, Director of Audit Services, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN.

Introduction

Purpose of document

In line with our audit strategy document, we have completed an interim audit. Key activities performed included the testing of a selection of system controls, holding discussions with management to update our understanding of the Council's activities and our assessment of the key risks and audit focus areas.

This report provides the Audit Committee with an update on:

1) Significant risks and other focus areas (pages four and five).
2) The results of the control testing (pages six to eight).
3) Best Value and wider scope (page nine).
4) Update on prior year recommendations (appendix one).

Significant risks and other focus areas in relation to the audit of the financial statements as identified in our audit strategy document, dated 28 March 2018:

The significant risks identified were:

— fraud risk from management override of controls;

— fraud risk from income recognition;

— retirement benefits; and

— valuation of property plant and equipment.

The other focus area identified was:

— capital expenditure

Acknowledgements

We would like to take this opportunity to thank officers and Members for their continuing help and cooperation throughout our audit work.

Significant risks and other focus areas

Update: significant risks and other focus areas

We outline below updates on significant risks included within our audit strategy. We will conclude on these areas in our Annual Audit Report.

Significant risk	Update from strategy
Fraud risk from management override of controls This is an assumed risk from ISA 240 "The auditors responsibilities relating to fraud in an audit of financial statements" on which we are required to report.	We performed controls testing over expenditure, bank reconciliations, revenue budget monitoring and general IT controls over key systems. In addition, we tested a sample of procurement arrangements for compliance with the relevant regulatory frameworks and internal controls. We did not identify instances where management override of control had occurred. Substantive procedures will be performed during the year end audit, including testing journal entries processed throughout the year, assessing accounting estimates and significant transactions that are outside the Council's normal course of business, or are otherwise unusual.
Fraud risk from income recognition This is an assumed risk from ISA 240. We consider the fraud risk from fees and charges income to be significant. We rebutted the assumed fraud risk in respect of government grants, local taxes and regulated rental income.	Testing over higher level controls are set out on page six, with no exceptions noted. We discussed fees and charges income with officers across different services to develop our understanding of the types of income which are recognised. Substantive procedures will be performed during the year end audit. We will consider each source of fees and charges income. We will analyse results against budgets and forecasts, performing substantive analytical procedures and tests of details.
Revaluation of property, plant and equipment There is a five year rolling valuations programme, with key categories being revalued in 2017-18 including car parks, investment properties and shops. Valuing fixed assets is an inherently judgemental area for all local authorities. There is a level of judgement involved in determining valuation assumptions which gives rise to a risk of misstatement.	We met with the valuations team and discussed the areas being revalued in 2017-18 as well as reviewing the five year rolling programme. The valuation date is 1 April 2017 as in prior years, with management performing an assessment of whether the valuations as at that date remain appropriate as at 31 March 2018. We assessed that the valuations team has sufficient qualifications, objectivity and independence to carry out valuations for the Council. As part of our year end audit, KPMG's in-house valuer will review the assumptions used to confirm they are reasonable and in line with the Code of Practice on Local Authority Accounting ('the Code'), with a focus on assets revalued under depreciated replacement cost, which is the most judgemental valuation basis. A sample of revaluations will be considered in more detail, including the roll forward to 31 March 2018 and consideration of impairment triggers. We will verify that revaluations are correctly disclosed in the accounts and that the accounting entries relating to the revaluation are correct.

Significant risks and other focus areas

Update: significant risks and other focus areas (continued.)

Significant risk	Update from strategy
Retirement benefits The Council is a member of the Tayside Pension Fund and recognised a defined benefit liability on its balance sheet of £250 million as at 31 March 2017. The determination of the net deficit is inherently judgemental given assumptions are used to derive the value.	The Council is participating in a pilot scheme which began in 2016 and requires all data including starters, leavers and changes of hours to be uploaded to an online system for transfer to Tayside Pension Fund each month. This data is taken directly from this system by the administrator. From discussion with management, we understand the data was transferred each month up to and including December 2017, with a technical fault causing a minor delay in January and February 2018 uploads. We understand the transfers were back in place by March 2018, and we will test the year end upload to verify the data used to calculate the net liability position is up to date. During the year end audit, a review of relevant assumptions and testing against our understanding of the Council will take place, for example salary increase assumptions. Prior to the fieldwork beginning in July, we will request the agreed assumptions for 2017-18 from management to facilitate this consideration and benchmarking by our internal actuary.
Other focus area	
Capital expenditure The Council has a six year £500 million capital plan, with a capital budget of £101 million for 2017-18. Due to the significance of this capital investment programme, and complexity of some of the projects, we consider there to be a risk of misstatement. This is an inherent risk to any entity delivering large capital projects.	We tested controls over capital monitoring and procurement of capital projects, the findings of which are outlined on page six. We met with management to discuss the progress of the key capital projects, such as the Perth City Hall upgrade and Cross Tay Link Road, to establish if these are currently in line with expected spend or where capital slippage or overruns had occurred. We reviewed the capital budget and plan for 2017-18 and future years, and will carry out substantive procedures over capital spend at the year end audit. This will include substantive sampling methods to evaluate the appropriateness of capital or revenue accounting classification by reference to supporting documentation, review of manual journals and testing of additions.

Control framework
System controls

In accordance with ISA 330 ''the auditor's response to assessed risks'', we designed and performed tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls over the man financial systems. Interim audit testing took place during February and March 2018. Overall we concluded that the control environment is effective.

Test	Description	Results
Bank reconciliations	Bank reconciliations are prepared monthly by a member of the income team and reviewed by a more senior officer. We tested a sample of two months for each of the eight bank accounts to verify they had been authorised and completed on a timely basis.	All reconciliations were completed and authorised as expected. No exceptions noted. ***Satisfactory***
Capital expenditure	Management monitor capital expenditure on all projects throughout the year. All large projects and any smaller projects nearing their approved spend will be considered by the Strategic Investments Group (''SIG'') and then by the Strategic Policy and Resource committee (''SP&R'') as appropriate. Approval is required for any overspends or adjustments against original budgets.	We carried out a walkthrough of a major capital project to understand the level of monitoring and scrutiny which takes place We obtained detailed minutes and reports on the spend to date and reasons for any movement from budget. We conclude there is adequate scrutiny over capital expenditure which is minuted and discussed by those charged with governance. ***Satisfactory***
Revenue budget monitoring	The Council has a robust revenue budget setting process, with involvement of key members of staff across the Council. Performance against revenue budget is monitored on a regular basis and formally reported to the Strategic Policy and Resources Committee via the budget monitoring reports in September, November, February and April. Three quarters' reports were considered to confirm that a sufficient level of detail was presented to and considered by the committees and that a level of precision is used to determine which variances require further analysis and discussion.	Testing confirmed that budget monitoring arrangements over revenue are designed, implemented and operating effectively. ***Satisfactory***

Control framework
System controls (continued)

Test	Description	Results
Payroll	A sample of two months control sheets were tested, which record that the stages of the payroll process have been completed, before authorising the payroll and completing the BACS runs. A sample of two months' BACS runs were reviewed to confirm the payment schedule was reconciled to the net pay analysis report and appropriately authorised. The annual service establishment report was reviewed to determine whether it had been signed off by each service to confirm all employees are still actively employed by the Council.	All control sheets recorded key stages of the pay run and had been marked as completed, with the pay run being marked as ready for processing. Both BACS runs had been reconciled and authorised by an authorised signatory in advance of the pay run. We confirmed that all four services had completed and signed the service establishment report. ***Satisfactory***
Cost of services (non-payroll expenditure)	A sample of 25 purchase orders were tested and agreed to invoice and checked they had been stamped with a goods received note.	All purchase orders could be matched to an invoice or system for procurement cards, and were recorded as matched by an appropriate officer. ***Satisfactory***
Procurement	The Council has well defined processes for the awarding of contracts, with written procedures to be followed for each contract type and value. Procurement testing covered a sample of 12 contracts awarded in the year, split between those which had gone through the quotation process and those which required to be tendered. We confirmed that they had followed the correct procurement route based on value and reviewed the evidence of the tender evaluation process.	Testing confirmed that the selected contracts had followed the correct procurement route based on value. ***Satisfactory*** As part of the year end testing, we will consider the procurement process and contracts entered into as part of the best value assessment over the Council's arrangements for Continuous improvement, and Leadership, governance & scrutiny.
BACS authorisation	BACS payment runs must be approved by an authorised member of the finance team. A further check is made on individual payments over £75,000. We tested a sample of 15 BACS payments to verify they had been authorised.	All BACS runs had been approved by an authorised officer. No exceptions noted. ***Satisfactory***

Control framework
System controls (continued)

Test	Description	Results
General IT controls	We performed testing over key IT systems which we will place reliance on as part of our audit, which included Integra and Resource Link. We considered: — programme changes were authorised and requested by the appropriate officers; — user access was authorised over starters and amendments; — leavers access was removed timeously; and — appropriate users were assigned system administrator user access.	We met with management to understand the key systems and approach to controls in advance of testing to allow us to scope our work effectively. Overall controls were found to be operating effectively within IT. ***Satisfactory*** As part of our year-end audit work, we will undertake testing over the Northgate IT system considering programme changes, user access over starters and leavers, leavers timeous removal, and appropriate user access.
Housing rents System	We tested two months' reconciliations between the housing rents system (Northgate) and the general ledger (Integra) to verify officers completed this reconciliation on a timely basis and any reconciling items were followed up and investigated.	We found the reconciliation to be operating effectively during the year. ***Satisfactory***
Policies and procedures	Staff have access to a number of key policies and procedures through the Council's intranet system 'eric'. We carried out a review of the policies held on the intranet to verify they covered expected information and were periodically updated.	All expected policies and procedures were available to staff on eric. Out of date polices were found on the system, which have been superseded. ***See page 13***

Wider Scope and Best Value

The Code of Audit Practice sets out four audit dimensions which, alongside Best Value, set a common framework for all audit work conducted for the Accounts Commission. These areas are: governance and transparency, financial management, financial sustainability and value for money. During our interim audit we considered these areas and will conclude our assessment in our Annual Audit Report. We provide an update below of work carried out so far on Best Value.

Area	Audit update
Best Value	In year two (2017-18), we will report on the areas of Leadership, Scrutiny and Governance and Continuous Improvement. This will be concluded in our Annual Audit Report. We have held planning discussions with officers to obtain an understanding of the Council's approach to Best Value and how this is embedded within the Council's culture. We have reviewed publically available evidence across these two Best Value areas and discussed with management, requesting further support or explanation for us perform the review of Best Value. We will continue to gather information and meet with officers to build or knowledge of Best Value in order to conclude on the two year two areas in our Annual Audit Report. In year three (2018-19) we will undertake a full Best Value audit over Perth and Kinross, with our fieldwork beginning in January 2019 and the final report being presented in October 2019. We will then carry out a follow up in year four (2019-20).
Wider scope	Specific risks in this area are set out in our audit strategy document and include demand pressures on the Council's services and the ability to achieving savings set out in the transformation programme. As part of our audit work during planning and interim, we carried out the following procedures; - reviewed update reports on transformation projects presented to committee for progress against savings targets; - held meetings with various officers including the Chief Executive, Head of Finance, Head of Legal and Governance, Capital Programme Manager and Chief Internal Auditor - reviewed policies and procedures and how these support officers in making informed financial decisions; and - reviewed budget monitoring reports to understand over and underspends against budget for different services in the year. We use the above to inform our work on the four wider scope areas above and Best Value, and will report our conclusion in our Annual Audit Report. We submitted a return to Audit Scotland in February 2018, assessing the Council's participation in the NFI against Audit Scotland criteria. The results show that overall engagement with NFI is good, with only minor improvements identified.

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Appendices

Appendix one

Prior year recommendations

This section provides an update on prior year external audit recommendations, to determine whether they have been addressed. The table below summarises the recommendations made during the 2016-17 audit.

Priority rating for recommendations		
Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the Council or systems under consideration. The weaknesses may therefore give rise to loss or error.	Grade two (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	Grade three (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Original finding and risk	Recommendation	Original management actions	Status
Journals review			
Grade Three Controls testing was performed over journals by selecting a sample of 25 journal entries and checking the review. In all cases a different officer had reviewed the journal compared to who had raised it, therefore the segregation of duties control is operating effectively. However there is no documentation of who has the authority to review journals, therefore we cannot assess it will always be an officer with sufficient experience who is carrying out this review.	It is recommended that controls over journals are strengthened: — the general ledger procedures manual should be updated to give clearer description of who can review journals. This should include a description of officer grade and journal value. — individuals involved in preparing and reviewing journals should be reminded of the procedures manual and the importance of complying with this.	General ledger manual will be updated to provide guidance on the roles and responsibilities of officers involved in checking journals. It shall provide a checklist for authorisers and examples of which officers should be reviewing / approving journals. **Responsible officer** General Ledger Controller	**Ongoing** We confirmed that the general ledger manual is still in the process of being updated with management's proposed actions.

Prior year recommendations (continued)

Original finding and risk	Recommendation	Original management actions	Status
Service Pack Authorisation			
Grade Two The financial statements are prepared using 16 service packs from a number of departments. These packs are consolidated into an extended trial balance and post-closing adjustments are then made to derive the final accounts. These packs are required to be signed by a preparer and authoriser, confirming they are complete and accurate. A management checklist is also prepared for packs, to show which checks the authoriser has performed. Testing carried out on the 2015-16 packs identified three that had not been authorised, while several had missing or incomplete management checklists. In a number of cases questions had been raised on the management checklist but no follow up had been documented, and it is unclear if issues had been resolved. There is a risk that the information used to prepare the financial statements is not complete, accurate or fully reconciled to supporting documentation.	It is recommended the controls over the authorisation of service packs are strengthened by: — ensuring all packs are signed as having been reviewed by the responsible officer for that service; — completing management checklists for each service pack, marking any questions that are not applicable as such, rather than leaving them blank; — reminding staff which, if any, corporate packs require a management checklist. — ensuring questions raised on the management checklist show evidence of follow up to ensure issues are resolved and there is a clear audit trail.	An instruction will be issued to all reviewers to ensure that accounts pack include an Accounts Preparation Certificate which is completed by preparers and reviewers. The instruction will also remind officers of the importance of completing the managers checklist and documenting issues that are identified during the review process **Responsible officer** Chief Accountant	**Implemented** We confirmed that this action point was implemented in May 2017, and that all service packs relating to the 2016-17 financial statements audit were authorised.

Prior year recommendations (continued)

Original finding and risk	Recommendation	Original management actions	Status
Checklist for updating polices			
Grade Three Policies and procedures are held on the Council's intranet which is available to all staff. From a review of key policies we identified that a number had not been updated on a timely basis. Two versions of the communications security policy were found. The most up to date version of this policy was dated 2010, however it states it is required to be reviewed every three years. The most up to date whistleblowing policy is not easily accessible to staff and also does not contain all information outlined in the Public Concern at Work's whistleblowing code of practice. There is a risk employees access policies and procedures which are not relevant to the current risk environment or contain out of date information therefore causing error or breach of laws and regulations.	It is recommended that: — a review is carried out of existing polices on the intranet and any old or superseded policies are removed; — the whistleblowing policy is made available on the intranet and is updated to contain all items required by the whistleblowing code of practice; and — a checklist should be kept of the key polices and when these were last updated, with evidence of review within the required timescale.	Services will be reminded of the need to ensure all policies are reviewed in line with agreed timescales, to document the review and to amend the date of policy to reflect the review. Services will also be reminded of the need to ensure that old or superseded policies on the intranet are either clearly marked as such or are removed from the intranet. The whistleblowing policy is available on the intranet and is maintained appropriately. Consideration will be given to creating and maintaining an appropriate checklist of Council policies. **Responsible officer** Information Compliance Manager	**Ongoing** We confirmed that a review of all policies was underway which are held on the intranet. The Information Compliance Manager is working on a checklist to monitor when policies are reviewed and sanitising the intranet to remove old polices.

Prior year recommendations (continued)

Original finding and risk	Recommendation	Original management actions	Status
General IT Controls - Leavers			
Grade Three During testing of general IT controls it was identified that some staff members who had left the Council had not had their user access removed (three from a sample of 16). Whilst there was evidence that these individual staff members had not accessed the system since their departure date, it highlights a control deficiency over removal of user access rights. The risk of unauthorised access to Integra and Resource Link was countered by mitigating controls at the system specific level. However there is a risk that former members of staff may access the Council's computer systems after their departure date. Depending on their access levels they would therefore potentially be able to make fraudulent or malicious use of council IT systems.	It is recommended that controls over the removal of leaving staff members' access are strengthened: — monthly reports of all leavers received from HR should be printed off or saved electronically; — each leaver on the report should be marked as having had their access removed; — the report should be signed and dated by the person performing the control to confirm completion, and — a designated member of IT management should regularly review the existence of the monthly leaver reports to confirm the control has been performed.	From discussion with the IT department the leavers report was not being processed correctly during the first half of 2016. This was due to staffing issues and has now been corrected. Our testing of January 2017 confirmed all leavers had been removed. **Responsible officer** Corporate IT Manager	**Implemented** We confirmed as part of the prior year audit that the recommendations were implemented in April 2017. As part of the audit in 2017-18, we tested these controls and found no issues as reported on page eight.

Prior year recommendations (continued)

Original finding and risk	Recommendation	Original management actions	Status
SWIFT exception reports efficiency			
Grade Three Exception reports are produced each week on data held in the SWIFT system relating to residential care homes. At present, and in line with prior year recommendation, all 14 of these reports are printed, dated, signed and held for 18 months. While this is helpful for audit evidence it creates a large amount of paperwork and takes up officers time in printing and documenting these reports. There is an opportunity to use staff time more efficiently.	It is recommended that a control sheet is put in place listing the 14 exception reports and whether any exceptions were noted. If there were no exceptions for a specific report this should be documented, initialled and dated by the officer who checked the report. An exception report with zero entries does not have to be printed, however this should still be held electronically. For cases where exceptions do exist these could be evidenced and stored electronically	The service accept the recommended changes to the recording of SWIFT exception reports and the efficiency that the changes will bring. **Responsible officer** Business and Resource Manager	**Implemented** We confirmed as part of the prior year audit that the recommendations were implemented in April 2017.

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