External Audit ISA260 Report 2017/18

Harborough District Council

July 2018

Summary for Governance and Audit Committee

This document summarises the key findings in relation to our 2017-18 external audit at Harborough District Council ('the Authority'). This report covers both our on-site work which was completed in February and June 2018 on the Authority's significant risk areas, as well as other areas of the financial statements, and the control environment in place to support the production of timely and accurate financial statements.

Organisational and IT control environment	We reviewed your IT control environment and identified weaknesses in respect of the new payroll system. We had to complete additional work in order to gain assurance over the payroll expenditure figures from the system provided by Leicester City Council. We have raised a recommendation which can be found in **Appendix 1**.
Controls over key financial systems	We have tested controls as part of our focus on significant audit risks and other parts of your key financial systems on which we rely as part of our audit. Based on the work performed, we are satisfied that the controls are performing effectively (except for the payroll issues). We are able to place reliance on the Authority's control framework.
Accounts production	We received a complete set of draft accounts on 30 May 2018, which is before this year's statutory deadline of 31 May 2018. The Authority continues to have a good financial reporting process as illustrated by finalising the accounts in a shorter timescale.

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.

Based upon our initial assessment of risks to the financial statements (as reported to you in our *External Audit Plan 2017/18*) we identified the following significant risks (excluding those mandated by International Standards on Auditing – see **Page 9 and onwards**):

- **Valuation of PPE** – The Authority operates a cyclical revaluation approach. The Code of Practice on Local Authority Accounting in the United Kingdom 2017-18 ('the Code') requires that all land and buildings be held at fair value. We considered the way in which the Authority ensures that assets not subject to in-year revaluation are not materially misstated. We also reviewed the instructions and source of the information provided to, and used by, the valuer to inform the Authority's valuation. We note that the last full revaluation undertaken by the Authority was four years ago, therefore assets not revalued in 2017/18 should be revalued in 2018/19 to comply with the Code of Practice on Local Authority Accounting in the United Kingdom 2017-18 ('the Code'). We have raised a recommendation which can be found in **Appendix 1**.
- **Pensions Liabilities** – The valuation of the Authority's 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 process that the Authority has in place over the information sent directly to the Pension Fund and reviewed management assessment of assumptions used in the valuation report and accounts.

We have not identified any material audit adjustments.

Subject to clearance of our final queries and final (including Director) review we are moving into the completion stage of the audit. We will not be able to issue our certificate alongside the opinion and VFM conclusion due to the Whole of Government Accounts work being outstanding (the deadline for submission is 31 August).

Summary for Governance and Audit Committee (cont.)

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 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 audit. As a result of this we identified the following significant VFM audit risk:

— **Delivery of financial and saving plans –** The Authority continues to face similar financial pressures and uncertainties to those experienced by others in the local government sector. For 2017/18, the Authority has set a balanced budget through the use of planned reserves of £0.649m and has detailed further savings and income generation plans totalling £0.700 million. The Authority's Efficiency Plan reported that the Authority is expecting to identify efficiencies in excess of £0.600m in 2018/19 and £0.672m in 2019/20 to balance the budget. As a result, the need for savings and income generation plans will continue to have a significant impact on the Authority's financial resilience. During 2017/18 a major planning application for storage and distribution at Magna Park was not approved by the Authority. Subsequently an appeal has been lodged to the Planning Inspectorate. The Local Plan had identified the need for this capacity to be provided during the Local Plan period. In addition the potential loss of retained business rates growth arising from the original application impacts on the future financial sustainability and resilience of the Authority. We reviewed the arrangements the Authority has in place to ensure financial resilience.

See further details on **Page 21**.

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 relation to our 2017/18 audit.

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 continued 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 except for implementation of the new payroll system.

Apart from the payroll system we 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 are in place. 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 tested controls over access to systems and data, system changes, system development and computer operations.

Key findings

We consider that your organisational and IT controls are effective overall except for the weakness noted below:

Issue: The Authority's payroll function is outsourced to Leicester City Council (LCC). During the audit period, LCC migrated to a new payroll processing software system. Our IT controls testing did not provide the required level of assurance. We had to complete additional work to gain assurance over the Authority's payroll expenditure included in the statement of accounts. We have made one recommendation to strengthen the IT control environment - see **Appendix 1.**

Aspect of controls	Assessment
IT controls:	
System changes and maintenance	2
Access to systems and data	2
Development of new systems and applications	3
Computer operations and end-user computing	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

From the testing undertaken, the controls over all of the key financial systems within our scope are sound.

Work completed

We review the outcome of internal audit's work on the financial systems to influence our assessment of the overall control environment, which is a key factor when determining the external audit strategy.

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.

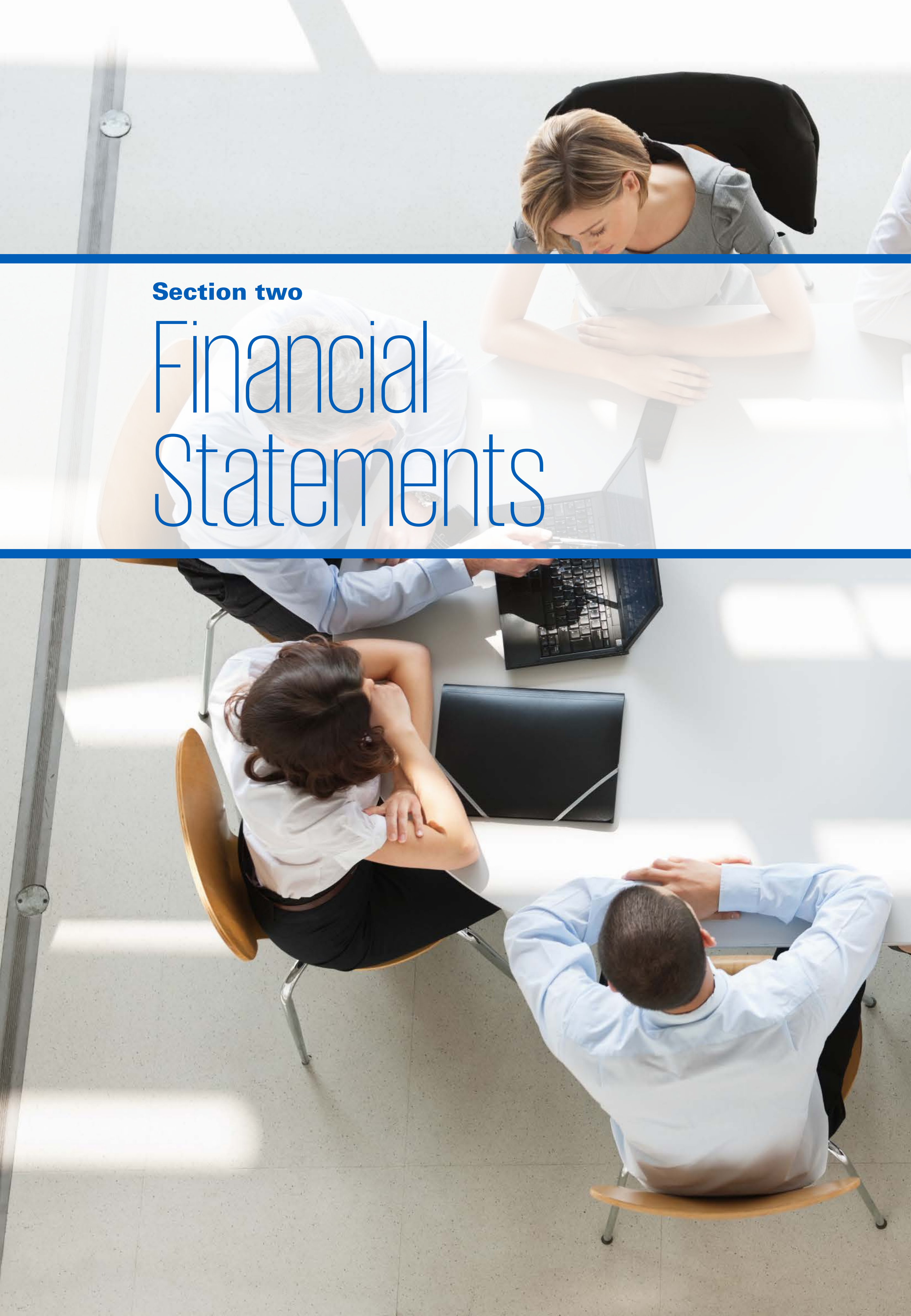
Our assessment of a system will not always be in line with your internal auditors' opinion on that system. This is because we are solely interested in whether our audit risks are mitigated through effective controls, i.e. whether the system is likely to produce materially reliable figures for inclusion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

Key findings

We have tested controls as part of our focus on significant audit risks and other parts of your key financial systems on which we rely as part of our audit. Based on the work undertaken, we have determined that the controls over the key financial systems within our scope are sound (excepting the outsourced payroll issues noted on the previous page).

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 good.

The Authority has implemented fully two recommendations and one recommendation has been superseded.

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 emerged.

We consider that the overall process for the preparation of your financial statements is good, and enabled the Authority to meet the tighter submission deadline of 31 May 2018.

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.

Further commentary on the Authority's arrangements in place to secure the financial resilience is included at **Page 21**.

Implementation of recommendations

We raised three recommendations in our ISA 260 Report 2016/17. The Authority has implemented fully two recommendations and one recommendation has been superseded. Further details are included in **Appendix 2**.

Completeness of draft accounts

We received a complete set of draft accounts on 30 May 2018 which was in advance of the statutory deadline.

Response to audit queries

We are pleased to report that our agreed turnaround time for dealing with audit queries was achieved by officers, including those who are not part of the finance team. As a result of this, all of our audit work was completed within the timescales expected.

Quality of supporting working papers

We issued our Accounts Audit Protocol to Finance Services Manager (Deputy S.151 Officer) in February 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.

We worked with management to ensure that working paper requirements are understood and aligned to our expectations. We are pleased to report that this has resulted in good quality working papers with clear management trails.

Specific audit areas

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

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

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. 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. This creates a risk that the carrying value of those assets not revalued in year differs materially from the year end fair value. The Authority have also appointed a new external valuer to undertake the revaluation of PPE during 2017/18. This further creates a risk that the carrying value of those assets subject to revaluation will fluctuate significantly from previous valuations due to different valuation methodology used by valuer.
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. We considered whether the Authority sufficiently challenged any significant movements in valuation. 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 determined that the valuation is appropriately stated. We however note that the last full revaluation undertaken by the Authority was four years ago, therefore assets not revalued in 2017/18 should be revalued in 2018/19 to comply with the Code. We have raised a recommendation which can be found in **Appendix 1**.

Specific audit areas (cont.)

Significant Audit Risks

Risk:	**Pension Liabilities** The net pension liability represents a material element of the Authority's balance sheet. The Authority is an admitted body of Leicestershire County Council, 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 on the net pension liability as accounted for in the financial statements.
Our assessment and work undertaken:	As part of our work we reviewed the process that the Authority has in place over the information sent directly to the Pension Fund. The Pension Fund is responsible for submitting the information to the Scheme Actuary. This included consideration of the process and controls with respect to the assumptions used in the valuation of scheme assets. We also liaised with the auditors of the Pension Fund in order to gain an understanding of the effectiveness of those controls operated by the Pension Fund. We also evaluated the competency, objectivity and independence of Hymans Robertson. We also reviewed management assessment of assumptions used in the valuation report and accounts. Work at the Leicestershire Pension Fund is on-going due to clarifications being sought from the actuary. We have set out our view of the assumptions used in valuing pension assets and liabilities at **page 14.**

Specific audit areas (cont.)

Other areas of audit focus

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

Issue:

Faster Close

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.

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) 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 Governance and Audit Committee meeting schedules have been updated to permit signing in July; and
- Applying a shorter paper deadline to the July meeting of the Governance and 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 (WGA) 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 in advance of the statutory deadline of 31 May 2018. The quality of this draft was consistent with that of prior years, with only minor presentational adjustments were identified. Our audit certificate is likely to be withheld to allow us to report on your WGA return (31 August deadline).

Specific audit areas (cont.)

Other areas of audit focus (cont.)

Issue:	**Provision for Business Rates Appeals** The level of business rates appeals has not significantly reduced nationally and the Valuation Office Agency (VOA) has revalued the rateable value of business properties on 1 April 2017 to reflect change in the property market. There is a continuing risk that the amounts set aside as provisions may not be reasonable. The Authority's provision is expected to be material (2016/17: £2m).
Our assessment and work undertaken:	We reviewed the basis of 2017/18 business rates provision. The Authority's share of provision for business rates appeals as at 31 March 2018 is £3.7m, which includes £1.5m relating to 2017 Valuation. Currently there is no available appeals information from the Valuation Office Agency relating to the 2017 Valuation following the introduction of a new appeals process. We agree that it is prudent to set aside this estimated amount as it is reasonable to assume that there will be successful appeals emerging from the new process. However, in our view, the most appropriate way to do this would be to create a reserve rather than a provision (which requires there to be an obligating event under IAS 37). Whilst we have as a result assessed the approach to provisions as cautious (see page 13), we recognise that management is not seeking to amend balances inappropriately as creating a reserve would have the same overall impact on the Authority's accounts. Officers have set out to us why they are content that they have met the requirements of IAS 37, and have confirmed that they will continue to review their approach to setting aside resources for potential 2017 appeals as updates are received from the Valuation Office.

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
Business Rates provision	1	3	We have set out our considerations on page 12.
Property Plant & Equipment:	3	3	The Authority has moved to a rolling valuation programme that ensures that all Property, Plant and Equipment required to be re-measured are revalued every 5 years. All property valuations have been carried out by an external valuer. Due to significant increase in build costs the Authority have indexed all of its depreciated replacement cost (DRC) property assets that have not been physically valued in 2017/18 to ensure they reflect the correct valuation as at 31 March 2018. We consider this to be a balanced approach.

Judgements (cont.)

Subjective area	Commentary
Valuation of pension assets and liabilities	The Authority continues to use Hymans Robertson 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. For example, a 0.5% change in the discount rate would change the net liability by £7.5 million. The below table compares Authority's and KPMG's assumptions using the range on the previous page. The overall set of assumptions proposed by the Authority can be considered to be balanced relative to our central rates for a typical UK scheme with a duration of 17.7 years and within our normally acceptable range. In particular the discount rate, which in isolation is outside the optimistic end of our normally acceptable range, is offset by the cautious assumption for pension increases such that the net rate (which drives the liability calculation) is comfortably within our normally acceptable range.

Assumption	Authority	KPMG	Assessment (See previous page for range definitions)	Commentary
Discount rate	2.70%	2.50%	6	The Authority's proposed assumption is considered to be optimistic and outside our normally acceptable range. The estimated impact of moving to the edge of KPMG's normally acceptable range for the discount rate would be to increase the disclosed liability by approximately £675k.
Pension Increase Rate	2.40%	2.16%	2	The proposed assumption is considered to be cautious but within our normally acceptable range.
Salary increases	CPI plus 1.0%	CPI plus 0% to 2.0%	3	We would typically expect salary increases to fall in the range of CPI plus 0% to 2%. Salary increase assumptions have been derived consistently with the approach taken at the most recent LGPS valuation. We would consider this approach to be reasonable.
Life expectancy at retirement Males currently aged 45 / 65 Females currently aged 45 / 65	 23.8 / 22.1 26.2 / 24.3	 23.5 / 22.1 25.4 / 23.9	2	The life expectancies assumptions are consistent with those used in the most recent LGPS valuation and can be considered acceptable.

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 Governance and Audit Committee on 25 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 3**) for this year's audit was set at £0.55 million. Audit differences below £25k are not considered significant.

We did not identify any material misstatements. In addition, we identified a small number of minor presentational adjustments required to ensure that the accounts are compliant with the Code. We understand that the Authority will be addressing 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. One omission was identified in relation to the payroll system issues identified at Leicester City Council in 2017-18. The Authority have agreed to include details of this in the final version of the Annual Governance Statement, along with the mitigations put in place at Harborough District Council.

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.

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 Harborough District Council for the year ending 31 March 2018, we confirm that there were no relationships between KPMG LLP and Harborough District 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 5** in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Head of Financial Services for presentation to the Governance and Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

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

- Significant difficulties encountered during the audit;
- Significant matters arising from the audit that were discussed, or subject to correspondence with management;
- Other matters, if arising from the audit that, in the auditor's professional judgement, are significant to the oversight of the financial reporting process; and
- Matters specifically required by other auditing standards to be communicated to those charged with governance (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

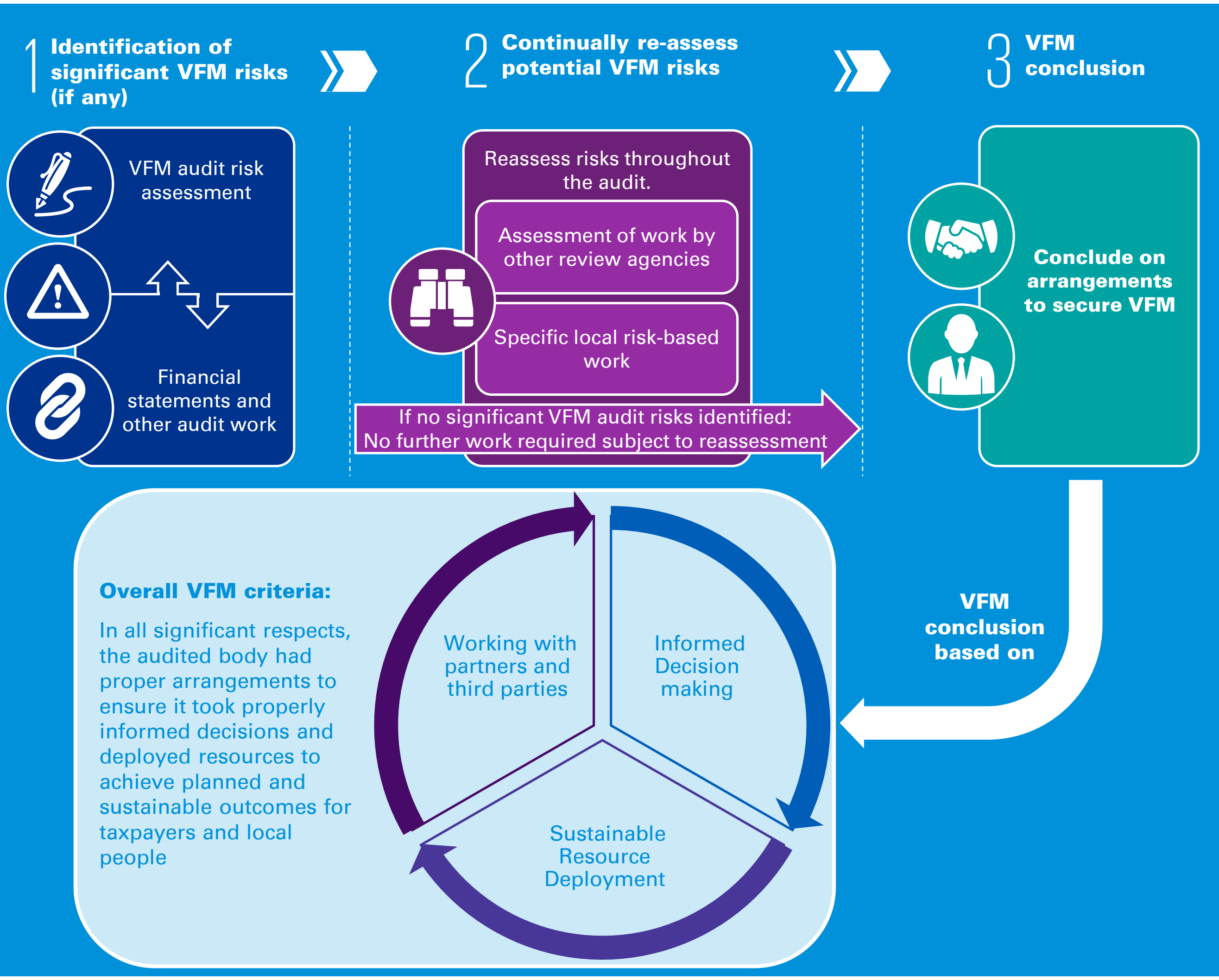
Our 2017-18 VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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 risk 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
Delivery of financial and saving plans	✓	✓	✓

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.

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* we have identified one risk requiring specific audit attention and procedures to address the likelihood that proper arrangements are not in place to deliver value for money.

We are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to this risk area are adequate.

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

VFM Risk	**Delivery of financial and saving plans** The Authority continues to face similar financial pressures and uncertainties to those experienced by others in the local government sector. For 2017/18, the Authority has set a balanced budget through the use of planned reserves of £0.649m and has detailed further savings and income generation plans totalling £0.700 million. The Authority's Efficiency Plan reported that the Authority is expecting to identify efficiencies in excess of £0.600m in 2018/19 and £0.672m in 2019/20 to balance the budget. As a result, the need for savings and income generation plans will continue to have a significant impact on the Authority's financial resilience. The Authority's Councillors have recently refused a major planning application for storage and distribution centre at Magna Park. The Authority needs to consider the impact of this decision on the future financial sustainability and resilience of the Authority including the deliverability of the Local Plan and the loss of potential business rates from the application not being approved.
Our assessment and work undertaken:	We have undertaken the following procedures over this VFM risk: — Reviewed the arrangements the Authority has in place to ensure financial resilience; — Reviewed the Authority's arrangements in place to deliver services through partnerships; and — Assessed the arrangements for ensuring that savings and additional income generating plans have been achieved as planned, including any actions taken by the Authority when schemes did not deliver as expected. We have completed our assessment by: — Regular liaison with the Joint Chief Executive, Head of Finance and Corporate Services and key personnel; — Review of the Medium Term Financial Strategy 2016/17 to 2019/20; and — Review of 2017/18 outturn vs budget and 2018/19 budget. Our findings are summarised below: — The Authority reported an underspend of £0.58m on its net expenditure revised general fund budget for 2017/18 of which £0.57m is carried forward into the 2018/19 budget. As a result of a decision made by the Authority to delay some of the planned expenditure in 2017/18 to 2018/19. The General Fund reserve stands at £6.5m as at 31 March 2018. This is still above the minimum General Fund reserve balance set by the Authority of 10% of net expenditure, which for 2017/18 is £1.167m.

Specific value for money risk areas (cont.)

Significant VFM Risks (cont.)

Our assessment and work undertaken:

- The Authority has set a General Fund balanced budget of £11.2m for 2018/19 with savings and income generation opportunities of £0.66m and planned use of reserves of £1.52m. The use of planned reserves still enables the Authority to have General Fund reserve of £4.62m as at 31/03/2019 (forecast), which is above the minimum General Fund reserve balance set by the Authority of 10% of net expenditure, which for 2018/19 is £1.126m.
- The Authority has refreshed its Medium Term Financial Strategy 2016/17 to 2019/20 though its Efficiency Plan in October 2016. Based on these assumptions the Authority is currently projecting a budget shortfall of £0.672m in 2019/20, which needs to be identified through savings and income generation opportunities.
- The Authority's Councillors refused a major planning application for storage and distribution centre at Magna Park. Subsequently an appeal has been lodged to the Planning Inspectorate. It is important that the Authority monitors the impact of this decision.
- The Authority works with a number of third party partners to deliver services including working with the Leicestershire Revenues and Benefits Partnership, utilising internal audit from Local Government Shared Services and payroll services from Leicester City Council. The Authority also works with partners through its community safety partnership to reduce the incidents of anti social behaviour, substance misuse, acquisitive crime and raise awareness of cyber crime within the district.
- Like most of local government, the Authority faces a challenging future driven by funding reductions and an increase in demand for services. This is further complicated by the uncertainty relating to the future of financing of local government, particularly business rate reform, fair funding review and the strategy for funding social care, as well as the more general uncertainties in relation to Brexit.
- Although the Authority is in a relatively good position financially at present, it is likely that it will still need to make tough decisions ahead to deliver balanced budgets over the coming years, and also maintain strict budgetary control to minimise overspends and continue to monitor delivery of savings targets tightly.

Appendices

Appendix 1:

Key issues and recommendations

Our audit work on the Authority's 2017/18 financial statements has identified two issue. 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: 2	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: 0

No.	Risk	Issue & Recommendation	Management Response
1	2	**Revaluation of land and buildings** The Code requires that assets are revalued once every five years as a minimum. The last full revaluation was four years ago, but in 2017/18 the Authority has moved to a rolling programme of valuing 20% of assets per year. However all remaining 80% of assets will need to be revalued in 2018/19 to avoid exceeding the 5 year maximum. ***Risk*** Without action being taken 60% of assets will have a valuation that is out of date and not Code compliant at the end of 2018/19. ***Recommendation*** The Authority should ensure assets not revalued in 2017/18 should be revalued in 2018/19 in order to comply with the Code.	This recommendation is noted. We will liaise with our external Valuer to ensure the remaining 80% of assets are revalued in 2018/19. ***Responsible Officer*** Finance Services Manager ***Implementation Deadline*** 31 March 2019

Appendix 1:

Key issues and recommendations

No.	Risk	Issue & Recommendation	Management Response
2	2	**Payroll System** The Authority's payroll function is outsourced to Leicester City Council (LCC). During the audit period, LCC migrated to a new payroll processing software system. Our IT controls testing did not provide the required assurance. We understand that LCC officers are reviewing the position. ***Risk*** There is a risk that the Authority will have to continue to carry out additional checks on payroll figures if there are on-going issues with the payroll system. ***Recommendation*** We recommend that the Authority seeks adequate assurances from the payroll provider that the new payroll system issues have been resolved, and if not, that the Authority carries out appropriate additional control checks.	The Authority commissioned an Internal Audit Review of the Authority's payroll internal control environment that provided sufficient assurance in respect of controls and reconciliations, which mitigated the transitional impacts of the Leicester City Council's payroll system migration. ***Responsible Officer*** Finance Services Manager ***Implementation Deadline*** Implemented

Appendix 2:

Follow-up of prior year recommendations

The Authority has implemented fully two recommendations raised through our previous audit work. One recommendation has been superseded.

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	3
Implemented/superseded in year	3
Outstanding at the time of our final accounts audit	0

No.	Risk	Issue & Recommendation	Management's Original Response	Status as at July 2018
1	2	**Documentation of management review of valuation assumptions** Property assets are revalued on an annual basis by a professional valuer in accordance with the CIPFA Code. Officers review the assumptions related to the estimation processes followed by the appointed valuers. However this review is not documented and as such could not be re-performed. **Recommendation** The Authority should document its review of these assumptions to strengthen the control process.	**Accepted** We are satisfied that our internal review process has given correct results within the financial statements. For future years we will add additional evidence of our review.	**Implemented** We have confirmed that the documentation of management review of valuation assumptions has been completed.

Appendix 2:

Follow-up of prior year recommendations

No.	Risk	Issue & Recommendation	Management's Original Response	Status as at July 2018
2	3	**Privileged user on efinancials system** We identified that the Head of Finance and Corporate Services (s151 Officer) had system administrator access to the eFinancials system. We would not expect a member of the senior management team to have privileged access to the finance system. **Recommendation** The Head of Finance and Corporate Services (s151 Officer) system administrator access for eFinancials system should be removed.	**Accepted** Head of Finance and Corporate Services (s151 Officer) system administrator access has been removed.	**Implemented** Our review of privileged users on the eFinancials system confirms that that the Head of Finance and Corporate Services system administrator access has been removed.
3	3	**Password criteria on Northgate payroll system** The Authority has access to Northgate payroll system, which is hosted by Leicester City Council (service organisation). Our testing identified that password are not changed within 90 days and system does not lock out users after three invalid attempts. We note that the payroll system has changed from 1 June 2017 to SAFE system. **Recommendation** The Authority should ensure that the previous weaknesses are not repeated in the new payroll system.	**Accepted** We have confirmed with Leicester City Council that the new Payroll system meets the password criteria.	**Superseded** During the audit period, Leicester City Council migrated to a new payroll processing software system. A new recommendation has been raised in **Appendix 1**.

Appendix 3:

Materiality and reporting of audit differences

The assessment of what is material is a matter of professional judgement 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 May 2018.

Materiality for the Authority's accounts was set at £0.55 million which equates to around 1.5 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Governance and Audit 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 Governance and Audit 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 £25k 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 Governance and Audit Committee to assist it in fulfilling its governance responsibilities.

Appendix 4:

Required communications with the Governance and Audit Committee

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

Required Communication	Commentary
Our draft management representation letter	We have not requested any specific representations in addition to those areas normally covered by our standard representation letter for the year ended 31 March 2018.
Adjusted audit differences	We have identified no adjusted material audit differences.
Unadjusted audit differences	We have identified no unadjusted audit differences.
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 Governance and Audit 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 significant deficiencies identified, see **pages 24 to 25**. 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	We will not be able to issue our certificate alongside the opinion and VFM conclusion due to the Whole of Government Accounts work being outstanding (the deadline for submission is 31 August).
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.
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, as appropriate, the firm and, when applicable, KPMG member firms have complied with relevant ethical requirements regarding independence. See **Appendix 5** 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 14.**
Significant matters discussed or subject to correspondence with management	There were no significant matters arising from the audit.

Appendix 5:

Declaration of independence

ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF HARBROUGH DISTRICT 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.

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

Appendix 5:

Declaration of independence (cont.)

Independence and objectivity considerations relating to the provision of services

Summary of fees

We have detailed the fees charged by us to the authority for professional services provided by us during the reporting period. 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 (note 1)	41,912*	41,912
Total audit services	**41,912**	**41,912**
Mandatory assurance services	14,335	15,668
Total mandatory assurance services Services	**14,335**	**15,668**

Note 1: Accounts opinion and use of resources work

For 2017/18, we have discussed additional fee with the Head of Finance and Corporate Services (s151 Officer) in relation to the additional payroll work undertaken to gain assurance over payroll expenditure in the statement of the accounts. This is still subject to final agreement and PSAA approval.

*Total excludes this additional fee.

Analysis of 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 £
Mandatory assurance services				
Grant Certification – Housing Benefit Subsidy Return	The nature of this mandatory assurance service is to provide independent assurance on this return. The fee is set by the PSAA. As such we do not consider it to create any independence threats.	Fixed Fee	15,668	14,335

The certification of Housing Benefit subsidy returns do not count towards the maximum 70% of audit fee threshold set by the NAO for non-audit work. We have not provided any non-audit services that would count towards that threshold.

Appendix 5:

Declaration of independence (cont.)

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the Governance and Audit Committee.

Confirmation of audit independence

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

This report is intended solely for the information of the Governance and Audit 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

The key contacts in relation to our audit are:

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. We draw your attention to the Statement of Responsibilities of auditors and audited bodies, which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

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

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