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# Report to those charged with governance (ISA 260) 2012/13

**Doncaster Metropolitan Borough Council**

16 September 2013

# Contents


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**This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled *Statement of Responsibilities of Auditors and Audited Bodies*. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document which is available on the Audit Commission's website at www.auditcommission.gov.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.**

**If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Paul Lundy, the appointed engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, 3rd Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 03034448330.**

# Introduction

**This report summarises:**

- the key issues identified during our audit of Doncaster Metropolitan Borough Council's (the Authority's) financial statements for the year ended 31 March 2013; and
- our assessment of the Authority's arrangements to secure value for money (VFM) in its use of resources.

## Financial statements

Our *External Audit Plan 2012/13* presented to you in April 2013. set out the four stages of our financial statements audit process.

Planning → Control Evaluation → Substantive Procedures → Completion

This report focuses on the second and third stages of the process: control evaluation and substantive procedures. Our on site work for these took place in two tranches during April 2013 (interim audit) and July to September 2013 (year end audit). We carried out the following work:

| | |
|---|---|
| Control Evaluation | Evaluate and test selected controls over key financial systems<br>Review internal audit function<br>Review accounts production process<br>Review progress on critical accounting matters |
| Substantive Procedures | Planning and performing substantive audit procedures.<br>Concluding on critical accounting matters.<br>Identifying audit adjustments.<br>Reviewing the Annual Governance Statement. |

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

| | |
|---|---|
| Completion | Declaring our independence and objectivity.<br>Obtaining management representations.<br>Reporting matters of governance interest.<br>Forming our audit opinion. |

## VFM conclusion

Our *External Audit Plan 2012/13* explained our risk-based approach to VFM work, which follows guidance provided by the Audit Commission. We have completed our work to support our 2012/13 VFM conclusion. This included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion;
- considering the results of any relevant work by the Authority, the Audit Commission, other inspectorates and review agencies in relation to these risk areas; and
- carrying out additional risk-based work.

## Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out the key findings from our audit work in relation to the 2012/13 financial statements.
- Section 4 outlines the key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1. We have also reviewed your progress in implementing prior year recommendations and this is detailed in Appendix 2.

**Acknowledgements**

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

# Headlines

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

| | |
|---|---|
| **Proposed audit opinion** | We anticipate issuing an unqualified audit opinion on 30 September 2013. We will also report that the wording of your Annual Governance Statement accords with our understanding. |
| **Audit adjustments** | To date our audit has identified a total of 7 audit adjustments. The net impact of these is to:<br>■ Increase the deficit on provision of services for the year to 31 March 2013 by £14.5 million; and<br>■ decrease the net worth of the Authority as at 31 March 2013 by £15.5 million.<br>These items have no net impact on the general fund balance at 31 March 2013 and two of the changes relate to the 2011/12 financial statements.<br>We have included a full list of significant audit adjustments at Appendix 3. All of these were amended by the Authority.<br>We have raised a number of recommendations in relation to the matters highlighted above, which are summarised in Appendix 1. |
| **Critical accounting matters** | We have worked with Officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately. |
| **Accounts production and audit process** | We have noted an improvement in the quality and timeliness of the supporting working papers but there is still progress to be made. Officers dealt efficiently with the majority of audit queries and the audit process has been completed within the planned timescales.<br>The financial statements presented for audit maintained the improvements noted in the Audit Commission's *Annual Governance Report 2011/12*. The financial statements presented for audit again required a significant number of amendments. The Authority need to ensure that quality assurance processes are sufficiently robust and well resourced to deliver further improvements in the quality of the financial statements and to reduce the number of errors.<br>The Authority has implemented the majority of the recommendations in the Audit Commission's *Annual Governance Report 2011/12* relating to the financial statements. |

# Headlines (continued)

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

| | |
|---|---|
| **Control environment** | The Authority's organisation and IT control environment is effective overall, and controls over the key financial systems are sound.<br>We have used the work of Internal Audit to inform our understanding of the Authority's control environment but we have not placed any direct reliance on individual piece of their work.<br>We did not identify any significant issues from our work on the control environment and we did not issue an interim report. |
| **Completion** | At the date of this report our audit of the financial statements is substantially complete, subject to completion of the following areas:<br>▪ The approval of the St Leger Homes audited financial statements at the Board meeting on 26 September 2013 ;<br>▪ Agreement of the consolidation adjustments in the group accounts to supporting evidence;<br>▪ Our review of the revised financial statements to confirm that all agreed amendments have been made; and<br>▪ Our work on the Whole of Government Accounts.<br>Before we can issue our opinion we require a signed management representation letter.<br>We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements. |

# Headlines (continued)

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

| | |
|---|---|
| **VFM conclusion and risk areas** | Subject to the comments below, we have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion on 30 September 2013.<br><br>The unqualified conclusion includes an additional paragraph containing a report by exception. This paragraph refers to the Secretary of State's decision to issue a direction requiring the Authority to bring in external management support for its Children's Services function. The Secretary of State referred in his statement to his view that the service did not provide value for money, and the VFM conclusion draws the reader's attention to this fact.<br><br>The Audit Committee will be aware that the Authority, in conjunction with the other three South Yorkshire Metropolitan Authorities and the Department for Business, Innovation and Skills, decided in August 2013 to wind-up Digital Region Ltd, the company set up to provide fast digital broadband across South Yorkshire. The Authorities took this decision with reluctance, given the considerable sums of public money, including EU grant-aid, that were invested in this company. However the Authorities' view was that continuing with the venture carried an unacceptable risk of further losses.<br><br>We have reviewed the accounting for these losses, are satisfied that it is materially correct, and have formed the view that we are not required to qualify our 2012/13 VFM conclusion for this matter. However, given the cost to the public purse, we strongly support the Authorities' plan to carry out a full independent evaluation of this project to see what lessons can be learned.<br><br>Our recommendations are summarised at Appendix 1. |

# Proposed opinion and audit differences

**Our audit has identified a total of 7 audit adjustments to date.**

**The impact of these adjustments is to:**

- **Increase the deficit on the provision of services for the year by £14.5 million; and**
- **Decrease the net worth of the Authority as at 31 March 2013 by £15.5 million.**

**The adjustments have no net impact on the general fund balance at 31 March 2013.**

## Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on 30 September 2013.

## Audit differences

In accordance with ISA 260 we are required to report uncorrected audit differences to you. We also report any misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities.

Our audit identified a total of 7 audit differences, which we set out in Appendix 3. It is our understanding that these will be adjusted in the final version of the financial statements.

The tables on the right illustrate the total impact of audit differences on the Authority's movements on the General Fund for the year and balance sheet as at 31 March 2013.

The nature of the adjustments, and the corresponding adjustments to unusable and earmarked reserves, mean that there is no net impact on the General Fund as a result of audit adjustments.

The most significant audit adjustments in terms of monetary value are:

- Losses on the revaluation of dwellings were understated by £14.5m;
- The 2011/12 group Comprehensive Income and Expenditure Statement was not restated to eliminate intra-group transactions with St Leger Homes of £40m; and
- The Cash Flow Statement was extensively revised to correct a large number of material errors and to eliminate a non-trivial balancing entry.
- The prior year Cash Flow Statement was also extensively revised to correct the incorrect classification of capital grants of £80m relating to HRA self-financing as cash flows relating to operating activities and to eliminate material balancing entries.

**Movements on the General Fund 2012/13**

| £m | Pre-audit | Post-audit | *Ref (App.3)* |
|---|---|---|---|
| Deficit on the provision of services | 40.5 | 41.5 | *4* |
| Adjustments between accounting basis & funding basis under Regulations | (35.7) | (35.7) | |
| Transfers to/ from earmarked Reserves | (4.5) | (5.5) | *4* |
| **Decrease in General Fund** | **0.3** | **0.3** | |

**Balance Sheet as at 31 March 2013**

| £m | Pre-audit | Post-audit | *Ref (App.3)* |
|---|---|---|---|
| Property, plant and equipment | 1,295 | 1,281 | *1* |
| Other long term assets | 40 | 40 | |
| Current assets | 111 | 110 | *2, 4* |
| Current liabilities | (166) | (176) | *3* |
| Long term liabilities | (784) | (774) | *3* |
| **Net worth** | **496** | **481** | |
| General Fund | (12) | (12) | |
| Other usable reserves | (89) | (88) | *4* |
| Unusable reserves | (395) | (381) | *1* |
| **Total reserves** | **(496)** | **(481)** | |

# Proposed opinion and audit differences (continued)

**The wording of your Annual Governance Statement accords with our understanding.**

### Presentational adjustments

In addition, we identified a small number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting the United Kingdom 2012/13 ('the Code')*. We understand that the Authority will be addressing these where significant.

### Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

- it complies with *Delivering Good Governance in Local Government: A Framework* published by CIPFA/SOLACE; and
- it is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

In the course of its preparation, we made a number of comments in respect of its format which the Authority amended before the Statement was published.

# Critical accounting matters

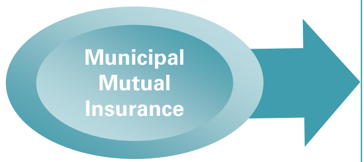
**We have worked with Officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.**

**The Authority accounted appropriately for its interest in Municipal Mutual Insurance.**

In our *External Audit Plan 2012/13*, presented to you in April, we identified the key risks affecting the Authority's 2012/13 financial statements.

We have now completed our testing of these areas and set out our evaluation following our substantive work.

The table below sets out our detailed findings for each risk.

| Key audit risk | Issue | Findings |
|---|---|---|
|   | The Authority's accounting treatment of its interest in the Municipal Mutual Insurance company (MMI) is affected by the status of MMI. Along with other Authorities, Doncaster MBC are the 'owners' of MMI and are ultimately responsible for MMI's liabilities. MMI faced financial difficulties some years ago and since it stopped taking in any new business it has been trying to achieve a solvent run-off. However its balance sheet as at June 2012 showed a net liability of £152 million, and consequently MMI announced that it would not achieve a solvent run-off and was triggering its Scheme of Arrangement. This will impact on the Authority's estimation of, and accounting for, its liabilities relating to claims made against MMI. There is a risk that the 2012/13 financial statements do not include the correct value or disclosure for the Authority's MMI-related liabilities. | We discussed the Authority's progress in accounting for this item with strategic finance staff regularly throughout the closedown process. We considered the proposed accounting treatment at this early stage.<br><br>As part of our work on provisions during our year end audit, we tested the accounting treatment for compliance with accounting standards and the Code. We also confirmed that the valuation is supported by the available evidence. |

# Critical accounting matters (continued)

**In August 2013 the Authority, in conjunction with its partner Authorities and the Department for Business, Innovation and Skills, took the decision to wind up Digital Region Ltd, the company set up to provide fast broadband in South Yorkshire. The Authority has adequate provision for the losses associated with this decision within its accounts.**

| Key audit risk | Issue | Findings |
|---|---|---|
|   | This company, a joint venture between the four South Yorkshire Metropolitan Authorities and Yorkshire Forward, has experienced trading difficulties. As a result, the Authorities involved have retendered the contract associated with the company and have provided for the costs associated with retendering. At the point of writing this retendering exercise is not yet complete. The estimate used to arrive at this provision will have a degree of estimation uncertainty and will also attract public interest. | We have liaised with the auditors of the other South Yorkshire Metropolitan Authorities to review the information used to estimate the provision for the costs associated with retendering. We are content that the figures used are reasonable.<br><br>We have also considered the impact of the decision to wind up the company on the financial statements. We have concluded that the Authority is correct to treat this decision as a non-adjusting event after the balance sheet date.<br><br>The provision of £6.4m included in the 2012/13 financial statements is estimated to be sufficient to meet the Authority’s best estimate of the likely costs of winding-up the company.<br><br>Recommendations are included in Appendix 1. |

# Critical accounting matters (continued)

**The quality and timeliness of working papers provided by the Authority has improved over previous years. The focus should now be on improving the quality assurance process over those working papers to avoid material and significant amendments to the accounts.**

| Key audit risk | Issue | Findings |
|---|---|---|
|   | In 2011/12 the accounts presented for audit were completed and presented in a timely manner, and the audit progressed in a more timely fashion than in previous years due to improvements in the quality and timeliness of the Authority's working papers.<br><br>However, the number of amendments required, although fewer than in previous years, suggested that additional time needed to be built into the closedown process to enable a considered quality assurance of the statements themselves.<br><br>Work also needs to be done to improve working papers and supporting information. Some supporting working papers were not available in the timescales agreed nor to an appropriate quality level. Whilst some working papers were of a good standard, a number were unclear and lacked sufficient detail or did not agree to the financial ledger or the statements. | The quality of the working papers and supporting information has improved in 2012/13. The majority of working papers were available on the agreed audit start date and, although there was some variation in quality, the working papers met the standards specified in our *Accounts Audit Protocol*.<br><br>These improvements in the quality of working papers and supporting information mean that the audit progressed more smoothly and in a more timely manner than in previous years.<br><br>The number of material and significant amendments required to the financial statements presented for audit has not reduced from previous years. This suggests that the issues with the time and resources allocated to the quality assurance process have still not been adequately addressed. |

# Accounts production and audit process

**Although quality assurance processes have been strengthened in 2012/13, this has not translated into a reduction in the number of material or significant amendments required to the accounts presented for audit**

**We have noted an improvement in the quality and the timeliness of the supporting working papers.**

**Officers dealt efficiently with audit queries and the audit process could be completed within the planned timescales.**

**The Authority has implemented the majority of the recommendations in our *ISA 260 Report 2011/12* relating to the financial statements.**

## Accounts production and audit process

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

We considered the following criteria:

| Element | Commentary |
|---|---|
| **Accounting practices and financial reporting** | Although the Authority has strengthened its financial reporting process through greater focus on quality assurance, this has not succeeded in reducing the number of material and significant amendments required. This suggests that further work needs to be done to build robust quality assurance of the financial statements themselves into the accounts production process.<br>We consider that accounting practices are appropriate. |
| **Completeness of draft accounts** | We received a complete set of draft accounts on time. |
| **Quality of supporting working papers** | Our *Accounts Audit Protocol*, which we issued on 12 February 2013 and discussed with Officers, set out our working paper requirements for the audit.<br>Most working papers were provided at the start of the audit but a small number were not produced until requested by auditors.<br>Overall the quality of working papers provided was better than in previous years and met the standards specified in our *Accounts Audit Protocol*. There was some variability in quality and quality assurance should focus on bringing all working papers to the same good standard. |
| **Response to audit queries** | Officers resolved most audit queries promptly and fully. In some cases, however, we experienced delays, specifically in obtaining payroll and housing benefit information. |
| **Group audit** | To gain assurance over the Authority's group accounts, we placed reliance on work completed by Beever and Struthers on the financial statements of St Leger Homes.<br>We are awaiting their confirmation of the work completed.<br>There are no specific matters to report pertaining to the group audit. |

## Prior year recommendations

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

The Authority has implemented the majority of the recommendations in the Audit Commission's *Annual Governance Report 2011/12* relating to the financial statements.

We re-iterate the importance of the outstanding recommendation in respect of quality assurance processes. This recommendation has been included in the Audit Commission's Annual Governance Reports for a number of years. Although there has been a greater focus on quality assurance in 2012/13, further work needs to be done.

Appendix 2 provides further details.

# Organisational and IT control environment

**Your organisational and IT control environment is effective overall.**

**We noted one area for further improvement.**

## 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.

## Key findings

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

We noted one area for further improvement:

- The security of access to the OneWorld system could be strengthened by tightening the parameters for password controls.

This weakness is mitigated by periodic monitoring of access to the system and has not had an impact on our audit strategy.

We understand that the new ERP system (from 30 September 2013) includes tighter password parameters and will address this weakness.

| Aspect | 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 |
| 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

**The controls over the majority of the financial systems 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.

We also work with your internal auditors to update our understanding of some of the Authority's key financial processes where these are relevant to our final accounts audit.

Where we have determined that this is the most efficient audit approach to take, we 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 the 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 the work of your internal auditors, the controls over the majority of the financial systems are sound.

We noted some weaknesses in respect of individual financial systems based on the work of internal audit but none that will impact on our audit. Where weaknesses exist, internal audit included recommendations in their reports as appropriate.

Our interim audit identified one issue which we would like to bring to your attention: lack of an authorisation control over journals. This is the same issue as reported to you in previous years and we anticipate that it will be addressed by the implementation of the new accounting system in 2013/14.

# Completion

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

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

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

## Declaration of independence and objectivity

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

In relation to the audit of the financial statements of Doncaster Metropolitan Borough Council for the year ending 31 March 2013, we confirm that there were no relationships between KPMG LLP and Doncaster Metropolitan Borough 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 Audit Commission's requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 4 in accordance with ISA 260.

## Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Director of Finance, a draft of which is reproduced in Appendix 5. We require a signed copy of your management representations before we issue our audit opinion.

We require the Authority to provide specific representation that it has made available to auditors all information in relation to Digital Region Ltd that is relevant to the preparation of the financial statements. This includes records, documents and details of other matters of which it is aware. We also require the Authority to confirm that all transactions in relation to Digital region Ltd have been recorded in the financial statements.

## 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 2012/13 financial statements.

# VFM conclusion

**Our VFM conclusion considers how the Authority secures financial resilience and challenges how it secures economy, efficiency and effectiveness.**

**We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.**

**Although the conclusion is unqualified, we have included an additional paragraph drawing attention to the Secretary of State's requirements relating to the transfer of Children's Services.**

## Background

Auditors are required to give their statutory VFM conclusion based on two criteria specified by the Audit Commission. These consider whether the Authority has proper arrangements in place for:

- securing financial resilience: looking at the Authority's financial governance, financial planning and financial control processes; and
- challenging how it secures economy, efficiency and effectiveness: looking at how the Authority is prioritising resources and improving efficiency and productivity.

We follow a risk based approach to target audit effort on the areas of greatest audit risk. We consider the arrangements put in place by the Authority to mitigate these risks and plan our work accordingly.

The key elements of the VFM audit approach are summarised in the diagram below.

## Conclusion

We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. However, we have included an additional paragraph in the conclusion to draw attention to the Secretary of State's statement about Doncaster's Children's Services.

| VFM criterion | Met |
|---|---|
| **Securing financial resilience** | ✓ |
| **Securing economy, efficiency and effectiveness** | ✓ |

The following pages include further details of our VFM risk assessment and our specific risk-based work.

# Specific VFM risks

**We have identified a number of specific VFM risks.**

**In most 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 carried out additional work in relation to Digital Region Limited.**

## Work completed

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

- assessed the Authority's key business risks which are relevant to our VFM conclusion;
- identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;
- considered the results of relevant work by the Authority, the Audit Commission, other inspectorates and review agencies in relation to these risk areas; and
- completed specific local risk based work in relation to the Authority's involvement (with other partners) in Digital Region Limited.

## Key findings

Below we set out the findings in respect of those areas where we have identified a residual audit risk for our VFM conclusion. Two of these were reported in or Audit Plan and one has emerged subsequently.

We concluded that we did not need to carry out additional work for two of these risks: Savings Plans and Children's Services. There was sufficient relevant work completed by the Authority, by the Audit Commission, and by other inspectorates and review agencies in relation to these risk areas.

We concluded that we needed to carry out additional work for one of these risks: Digital Region Limited. This work is now complete and we also report on this below.

# Specific VFM risks

**The outturn position of the Authority for 2012/13 was an under spend of £1.5m, with significant overspends in Children's and Young People's Services offset by savings in other Directorates.**

**The latest financial position for 2013/14 shows a small forecast overspend and the Authority expects to deliver savings in line with current plans.**

**The Authority faces a challenging task to deliver savings of £103m over the three years to 2016/17. It is important that the Authority quickly puts in place arrangements to deliver the full savings target so that plans can be implemented in good time.**

| Key VFM risk | Risk description and link to VFM conclusion | Assessment |
|---|---|---|
|  | In response to the cuts in funding from central government, the Authority has plans to reduce its spending by £109 million between 2013/14 and 2016/17. This is in addition to the £30 million savings planned for 2012/13. The Authority has a good track record of delivering savings, but will it find that the required reductions are increasingly hard to achieve in future years.<br><br>The Authority has embarked on a programme of change which is intended to deliver the required savings while minimising the impact on the range and quality of the Authority's services.<br><br>The Authority recognises that its plans for 2014/15 and beyond will need to deliver significant savings and it will need to carefully manage its savings plans to secure its long term financial and operational sustainability.<br><br>This is relevant to both the financial resilience and economy, efficiency and effectiveness criteria of the VFM conclusion. | The outturn position of the Authority for 2012/13 was an under spend of £1.5m. Overspends occurred in Children's and Young People's Services and in the Corporate Change Programme but these were offset but under spends in other Directorates resulting in the overall under spend. The most significant contributions to the under spend were savings in Treasury Management costs and lower than expected expenditure relating to individual budgets in Adult Services.<br><br>The approved budget for 2013/14 identified further savings of £26m to reach a balanced budget. The latest financial position shows a forecast overspend of £0.3m and the most recent reports state that savings will be achieved in line with the current plans.<br><br>The Authority expects to need to deliver savings of approximately £38m in 2014/15 and £37m in 2015/16 with a further £34m in 2016/17. These levels of savings will be harder to deliver than earlier years as the Authority has already developed and delivered the more straightforward savings opportunities.<br><br>There are already plans in place to develop savings of £59m towards the overall requirement of £109m over the next three years. Although the full impact of this gap will not be felt until later in 2014/15, it is important that the Authority quickly puts arrangements in place to develop plans for the remainder of the gap so that saving can be implemented in good time.<br><br>Recommendations are included in Appendix 1. |

# Specific VFM risks

**In August 2013 the Authority, in conjunction with its partner Authorities and the Department for Business Innovation and Skills, took the decision to wind up Digital Region Ltd, the company set up to provide fast broadband in South Yorkshire.**

**The Authority is planning to carry out an independent review of the lessons learned in relation to this project.**

| Key VFM risk | Risk description and link to VFM conclusion | Assessment |
|---|---|---|
|  | This company, a joint venture between the four South Yorkshire Metropolitan Authorities and Yorkshire Forward, has experienced trading difficulties. As a result, the Authorities involved have retendered the contract associated with the company and have provided for the costs associated with retendering. This retendering exercise is incomplete at the time of writing.<br><br>This is relevant to the economy, efficiency and effectiveness criteria of the VFM conclusion. | The re-procurement process continued throughout the 2012/13 financial year. Negotiations took longer than estimated due mainly to issues around State Aid and ERDF claw back that required a resolution from the European Commission (EC). In the light of the ongoing cost of supporting Digital Region Ltd throughout this period, the Authority, in conjunction with the other shareholders, took the decision to wind up the company in August 2013.<br><br>This decision will limit the Authority's exposure to future losses connected with Digital Region Ltd. It is also likely to lead to the overall cost being equal to or less than the provision of £6.4m included in the 2012/13 financial statements.<br><br>The Authority has actively reviewed the situation as it has developed throughout the 2012/13 financial year, and this ongoing monitoring has enabled it to take the difficult decision to wind up the company. As a result of this active involvement, we have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in respect of its investment in Digital Region Ltd during 2012/13.<br><br>We acknowledge the Authority is planning to carry out a review of the Digital Region Project to identify the lessons that should be learned from the initial decision to invest up to the final decision to close the company. This review should, ideally, be carried out as soon as possible and jointly with the other stakeholders.<br><br>Recommendations are included in Appendix 1. |

# Specific VFM risks

**We have taken account of the Secretary of State's direction for Children's and Young People's Services in drafting our VFM conclusion.**

**We have included a paragraph in the conclusion referring to this significant matter.**

| Key VFM risk | Risk description and link to VFM conclusion | Assessment |
|---|---|---|
|   | Following a visit by OFSTED in November 2012, the Secretary of State for Education issued a statutory direction in March 2013 that required the Authority to bring in external management support for the Children's and Young People's Service, particularly in respect of child protection. This will result in the service ultimately being passed over to an independent trust.<br><br>This action is potentially relevant to the economy, efficiency and effectiveness criteria of the VFM conclusion. | The Secretary of State's direction sets out his concerns about the speed of improvement and the need to ensure that children are protected. This is a serious finding. However, as the acknowledged problems within Children's and Young People's Services are not representative of the continued progress that the Council has made in 12/13 in relation to the costs, efficiency and/or productivity of the majority of its activities, we will not qualify the VFM conclusion in that respect. We have however included an "emphasis of matter" section within our VFM conclusion to draw attention to the Secretary of State's concerns. |

# Appendix 1: Key issues and recommendations

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

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

**We will formally follow up these recommendations next year.**

| Priority rating for recommendations | | |
|---|---|---|
| ❶ ***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. | ❷ ***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. | ❸ ***Priority three***: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them. |

| No. | Risk | Issue and recommendation | Management response / responsible officer / due date |
|---|---|---|---|
| 1 | ❷ | The Authority should commission a full independent review of the Digital Region Project to identify the lessons that should be learned. This review should be carried out as soon as possible and jointly with the other stakeholders. | |
| 2 | ❷ | The Authority should ensure it has appropriate arrangements in place to manage the closure of Digital Region Limited and to minimise the financial impact on the Authority. | |
| 3 | ❷ | The Authority should ensure that it develops savings plans to meet the full budget gap of £109m identified for financial years up to 2016/17. | |

# Appendix 2: Follow up of prior year recommendations

**Of the three recommendations in the Audit Commission's *Annual Governance Report* 2011/12, the Authority has fully implemented two and partially implemented one.**

**We re-iterate the importance of the outstanding recommendation. This should be implemented for the 2013/14 financial statements.**

**We will once again formally follow up this recommendation next year.**

This appendix summarises the progress made to implement the recommendations identified in the Audit Commission's *Annual Governance Report 2011/12* and re-iterates any recommendations still outstanding.

| Number of recommendations that were: | |
|---|---|
| Included in original report | 3 |
| Implemented in year or superseded | 2 |
| Remain outstanding (re-iterated below) | 1 |

| No. | Risk | Recommendation | Status as at 6 September 2013 |
|---|---|---|---|
| 1 | 2 | Ensure that quality assurance procedures linked to the production of the financial statements are sufficiently resourced to enable timely delivery. | The number of material and significant amendments required to the financial statements presented for audit has not reduced from previous years. This suggests that the issues with the time and resources allocated to the quality assurance process have still not been adequately addressed. |

# Appendix 3: Audit differences

**This appendix sets out the significant audit differences. It is our understanding that all of these will be adjusted.**

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 the Authority's case is the Audit Committee). We are also required to report all misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities.

## Corrected audit differences

The following table sets out the significant audit differences identified by our audit of Doncaster Metropolitan Borough Council's financial statements for the year ended 31 March 2013. It is our understanding that these will be adjusted. However, we have not yet received a revised set of financial statements to confirm this.

| | Impact | | | | | |
|---|---|---|---|---|---|---|
| **No.** | **Income and Expenditure Statement** | **Movement in Reserves Statement** | **Assets** | **Liabilities** | **Reserves** | **Basis of audit difference** |
| 1 | Dr Local Authority Housing (HRA) Expenditure £13,555k Dr Surplus/Deficit on Revaluation of Non Current Assets £1,035 k | Cr Other Comprehensive Income and Expenditure £1,035k Cr Adjustments Between Accounting Basis and Funding Basis Under Regulations £13,555k | Cr Property, Plant and Equipment £14,590k | | Dr Capital Adjustment Account £13,555k Dr Revaluation Reserve £1,035k | Gains and losses on the revaluation of council dwellings were interchanged in the housing asset register so that gains were treated and losses were treated as gains. This resulted in an understatement of the loss on revaluation. |

# Appendix 3: Audit differences (continued)

**This appendix sets out the significant audit differences. It is our understanding that all of these will be adjusted.**

| | Impact | | | | | |
|---|---|---|---|---|---|---|
| **No.** | **Income and Expenditure Statement** | **Movement in Reserves Statement** | **Assets** | **Liabilities** | **Reserves** | **Basis of audit difference** |
| 2 | | | Dr Short Term Investments £10,000k Cr Cash and Cash Equivalents £10,000k | | | A short term investments (with a term of more than 90 days) was incorrectly classified as a cash equivalent in the draft accounts. |
| 3 | | | | Dr Long Term Borrowings £10,000k Cr Short Term Borrowings £10,000k | | A loans with a term of less than one year was incorrectly classified as long term borrowing in the draft accounts. |
| 4 | Dr Children's and Education Services Income £927k | Cr Transfers to/from Earmarked Reserves £927k | Cr Debtors £927k | | Dr Earmarked General Fund Reserves £927k | A debtor for Dedicated Schools Grant income of £927k was incorrectly recognised in the draft accounts. |
| 5 | | | | | | The Cash Flow Statement was extensively reworked to correct five non-trivial errors. |
| | **Dr £15,517k** | **Cr £15,517k** | **Cr £15,517k** | **Nil** | **Dr £15,517k** | **Total impact of corrected audit differences on the 2012/13 accounts** |

# Appendix 3: Audit differences (continued)

**This appendix sets out the significant audit differences. It is our understanding that all of these will be adjusted.**

## Corrected audit differences – prior year

The following table sets out the significant audit differences identified by our audit of Doncaster Metropolitan Borough Council's financial statements for the year ended 31 March 2012. It is our understanding that these will be adjusted. However, we have not yet received a revised set of financial statements to confirm this.

| | Impact | | | | | |
|---|---|---|---|---|---|---|
| **No.** | **Income and Expenditure Statement** | **Movement in Reserves Statement** | **Assets** | **Liabilities** | **Reserves** | **Basis of audit difference** |
| 6 | Group Income and Expenditure Statement<br>Dr Local Authority Housing (HRA) Income<br>£35,225k<br>Cr Local Authority Housing (HRA)<br>£35,225k | | | | | The 2011/12 group Comprehensive Income and Expenditure Statement was not restated to eliminate intra-group transactions with St Leger Homes. |
| 7 | | | | | | The 2011/12 Cash Flow Statement was extensively revised to correct the misclassification of capital grants of £80m relating to HRA self-financing as cash flows relating to operating activities and to eliminate material balancing entries. |
| | **Nil** | **Nil** | **Nil** | **Nil** | **Nil** | **Total impact of corrected audit differences on the 2011/12 accounts** |

# Appendix 4: Declaration of independence and objectivity

**The *Code of Audit Practice* requires us to exercise our professional judgement and act independently of both the Commission and the Authority.**

## Requirements

Auditors appointed by the Audit Commission must comply with the *Code of Audit Practice* (the Code) which states that:

*"Auditors and their staff should exercise their professional judgement and act independently of both the Commission and the audited body. Auditors, or any firm with which an auditor is associated, should not carry out work for an audited body that does not relate directly to the discharge of auditors' functions, if it would impair the auditors' independence or might give rise to a reasonable perception that their independence could be impaired."*

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Audit Commission's Standing guidance for local government auditors (Audit Commission Guidance) and the requirements of APB Ethical Standard 1 *Integrity, Objectivity and Independence* (Ethical Standards).

The Code states that, in carrying out their audit of the financial statements, auditors should comply with auditing standards currently in force, and as may be amended from time to time. Audit Commission Guidance requires appointed auditors to follow the provisions of ISA (UK &I) 260 Communication of *Audit Matters with Those Charged with Governance*' that are applicable to the audit of listed companies. This means that the appointed auditor must disclose in writing:

- Details of all relationships between the auditor and the client, its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the client, its directors and senior management and its affiliates, that the auditor considers may reasonably be thought to bear on the auditor's objectivity and independence.
- The related safeguards that are in place.
- The total amount of fees that the auditor and the auditor's network firms have charged to the client and its affiliates for the provision of services during the reporting period, analysed into appropriate categories, for example, statutory audit services, further audit services, tax advisory services and other non-audit services. For each category, the amounts of any future services which have been contracted or where a written proposal has been submitted are separately disclosed. We do this in our Annual Audit Letter.

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from his. These matters should be discussed with the Audit Committee.

Ethical Standards require us to communicate to those charged with governance in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on our independence and the objectivity of the Audit Partner and the audit team.

## General procedures to safeguard independence and objectivity

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

# Appendix 4: Declaration of independence and objectivity (continued)

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

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

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

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

## Auditor declaration

In relation to the audit of the financial statements of Doncaster Metropolitan Borough Council for the financial year ending 31 March 2013, we confirm that there were no relationships between KPMG LLP and Metropolitan Borough 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 Audit Commission's requirements in relation to independence and objectivity.

# Appendix 5: Draft management representation letter

**We ask you to provide us with representations on specific matters such as whether the transactions within the accounts are legal and unaffected by fraud.**

**The wording for these representations is prescribed by auditing standards.**

**We require a signed copy of your management representations before we issue our audit opinion.**

**We require confirmation that the Authority has provided us with all information in relation to Digital Region Ltd that is relevant to the preparation of the financial statements.**

Dear Paul,

This representation letter is provided in connection with your audit of the financial statements of Doncaster Metropolitan Borough Council ("the Authority") for the year ended 31 March 2013, for the purpose of expressing an opinion:

- as to whether these financial statements give a true and fair view of the financial position of the Authority and the Group as at 31 March 2013 and of the Authority's and the Group's expenditure and income for the year then ended; and
- whether the financial statements have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

These financial statements comprise the Authority and Group Movement in Reserves Statements, the Authority and Group Comprehensive Income and Expenditure Statements, the Authority and Group Balance Sheets, the Authority and Group Cash Flow Statements, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement and the Collection Fund and the related notes.

The Authority confirms that the representations it makes in this letter are in accordance with the definitions set out in the Appendix to this letter.

The Authority confirms that, to the best of its knowledge and belief, having made such inquiries as it considered necessary for the purpose of appropriately informing itself:

**Financial statements**

1. The Authority has fulfilled its responsibilities, as set out in regulation 8 of the Accounts and Audit (England) Regulations 2011, for the preparation of financial statements that:
   - give a true and fair view of the financial position of the Authority and the Group as at 31 March 2013 and of the Authority's and the Group's expenditure and income for the year then ended; and
   - have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

   The financial statements have been prepared on a going concern basis.
2. Measurement methods and significant assumptions used by the Authority in making accounting estimates, including those measured at fair value, are reasonable.
3. All events subsequent to the date of the financial statements and for which the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 requires adjustment or disclosure have been adjusted or disclosed.
4. In respect of the restatements of the Group Comprehensive Income and Expenditure Statement and of the Authority and Group Cash Flow Statements made to correct material misstatements in the prior period financial statements, the Authority confirms that the restatement is appropriate.

**Information Provided**

5. The Authority has provided you with:
   - access to all information of which it is aware, that is relevant to the preparation of the financial statements, such as records, documentation and other matters;
   - additional information that you have requested from the Authority for the purpose of the audit; and
   - unrestricted access to persons within the Authority and Group from whom you determined it necessary to obtain audit evidence.
6. All transactions have been recorded in the accounting records and are reflected in the financial statements.

# Appendix 5: Draft management representation letter

**We ask you to provide us with representations on specific matters such as whether the transactions within the accounts are legal and unaffected by fraud.**

**The wording for these representations is prescribed by auditing standards.**

**We require a signed copy of your management representations before we issue our audit opinion.**

**We require confirmation that the Authority has provided us with all information in relation to Digital Region Ltd that is relevant to the preparation of the financial statements**

7. The Authority acknowledges its responsibility for such internal control as it determines necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In particular, the Authority acknowledges its responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

   The Authority has disclosed to you the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

8. The Authority has disclosed to you all information in relation to:

   a) Fraud or suspected fraud that it is aware of and that affects the Authority and the Group and involves:
      - management;
      - employees who have significant roles in internal control; or
      - others where the fraud could have a material effect on the financial statements; and

   b) allegations of fraud, or suspected fraud, affecting the financial statements communicated by employees, former employees, analysts, regulators or others.

9. The Authority has disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements.

10. The Authority has disclosed to you and has appropriately accounted for and/or disclosed in the financial statements in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.

11. The Authority has disclosed to you the identity of the Authority's and the Group's related parties and all the related party relationships and transactions of which it is aware and all related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

    Included in the Appendix to this letter are the definitions of both a related party and a related party transaction as the Authority understands them and as defined in IAS 24, except where interpretations or adaptations to fit the public sector are detailed in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

12. On the basis of the process established by the Authority and having made appropriate enquiries, the Authority is satisfied that the actuarial assumptions underlying the valuation of pension scheme liabilities are consistent with its knowledge of the business.

    The Authority further confirms that:

    a) all significant retirement benefits, including any arrangements that:
       - are statutory, contractual or implicit in the employer's actions;
       - arise in the UK and the Republic of Ireland or overseas;
       - are funded or unfunded; and
       - are approved or unapproved,
       - have been identified and properly accounted for; and

    b) all settlements and curtailments have been identified and properly accounted for.

13. The Authority has disclosed to you access to all relevant information of which it is aware in relation to Digital Region Limited such as records, documentation and other matters.

    All transactions in relation to Digital Region Limited have been recorded in the financial statements.

This letter was tabled and agreed at the meeting of the Audit Committee on 30 September 2013.

Yours sincerely,

Chair of the Audit Committee    Chief Financial Officer cutting through complexity™