



# Maintaining an effective control framework



North Yorkshire County Council 2015/16

North Yorkshire Pension Fund 2015/16

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This document summarises the key findings arising from our work to date in relation to the audit of the Council's and the Pension Fund's 2015/16 financial statements and the 2015/16 VFM conclusion.

## Scope of this report

This report summarises the key findings arising from:

- Our interim audit work at North Yorkshire County Council ('the Council') in relation to the Council's 2015/16 financial statements;
- Our interim audit work at North Yorkshire Pension Fund ('the Pension Fund') in relation to the Pension Fund's 2015/16 financial statements; and
- Our work to support our 2015/16 value for money (VFM) conclusion to the Council, up to April 2016.

## Financial statements

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

During March and April 2016 we completed our planning and control evaluation work. This covered:

- Review of the Council's overall organisational control environment, including the controls operating over the key Council's IT systems;
- Testing of certain controls over the Council's key financial systems; and
- Review of the Council's accounts production process, and the specific risk areas we have identified for this year.

## VFM conclusion

Our *External Audit Plan 2015/16* explained our risk-based approach to VFM work, which is supported by the Code of Audit Practice, published by the NAO in April 2015. We have completed some early work to support our 2015/16 VFM conclusion. This included:

- Assessing the potential VFM risks, and identifying the residual audit risks for our VFM conclusion;
- Considering the results of any relevant work by the Council, other inspectorates and review agencies in relation to these risk areas; and
- Identifying the additional risk-based work we will need to complete.

## Structure of this report

This report is structured as follows:

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

Our recommendations are included in Appendix 1.

## Acknowledgements

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



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

<p><b>Organisational and IT control environment – Council and Pension Fund</b></p>	<p>Our work has confirmed that the Council and Pension Fund's organisational and IT control environments are designed effectively and provided assurance that the environments support the production of materially correct financial statements.</p> <p>In addition to our routine audit work, we undertook specific work to gain assurance over the implementation of the Council's new financial system, including the transfer of balances from the old system to the new one.</p>
<p><b>Controls over key financial systems - Council</b></p>	<p>Our testing of relevant controls we identified in relation to payroll, business rates income and council tax income provided assurance over the material correctness of the transactions. Our work over the Council's non-pay expenditure is designed to utilise data and analytics techniques, and does not involve testing key controls. We have not yet assessed the controls over the Council's pension liabilities and its property plant and equipment balance, as many of the key controls in respect of these areas are operated during the closedown process.</p> <p>Our testing of the bank reconciliation process identified that the controls could be strengthened by implementing a clearly documented management review of the completed monthly reconciliation.</p>
<p><b>Controls over key financial systems – Pension Fund</b></p>	<p>Our testing of relevant controls we identified in relation to investment assets, benefits payable and contributions receivable provided assurance over the material correctness of the transactions. Our testing of the reconciliation to the general ledger for investment assets and contributions receivable will be undertaken at the final audit visit as these reconciliations are only undertaken as part of the year end closedown process.</p> <p>We were unable to complete our testing of the Pension Fund bank reconciliation as the information we required had not been provided by officers at the time of our visit.</p>
<p><b>Other financial controls and processes</b></p>	<p>Our testing of the Council's budget setting and monitoring process provided assurance that material errors would be detected and corrected.</p> <p>Our testing of the controls operating over the Council and Pension Fund journal transfers identified that there is no independent authorisation of journals, and that all officers with relevant access can post and authorise journals of any value.</p>
<p><b>Accounts production</b></p>	<p>Our review and testing of the Council's overall process for preparing the financial statements provides assurance that the process is effectively designed, and likely to produce financial statements that are materially correct.</p>



<p>This table summarises the headline messages. The remainder of this report provides further details on each area.</p>	<p><b>Specific risk areas for the Council and Pension Fund</b></p>	<p>Our audit plan identified the following specific risk areas for the Council and Pension Fund:</p> <ul style="list-style-type: none"> <li>— New financial system (Council and Pension Fund); and</li> <li>— Possible impairment of PPE due to flooding (Council only).</li> </ul> <p>Our work to date over these areas has provided assurance that:</p> <ul style="list-style-type: none"> <li>— The balances in the previous financial system have been fully and accurately transferred across to the new financial system; and</li> <li>— No material issues have been identified that impacts on the Council's ability to produce materially correct financial statements.</li> <li>— The Council has considered the impact of the flooding on the value of its land, buildings and infrastructure assets, and understands the accounting requirements which would be necessary in the financial statements should there be any impairments required. We will complete our testing over this risk area during our final audit visit.</li> </ul>
	<p><b>VFM conclusion audit work</b></p>	<p>We have completed our VFM conclusion risk assessment work and have not identified any specific significant VFM risks.</p> <p>In carrying out this assessment we have taken into account the Council's response to the financial challenges that it faces, including the North Yorkshire 2020 council plan, and the progress with the recent Local Government Association peer review.</p> <p>We will revisit that assessment work during our final audit visit to ensure that our conclusions remain valid.</p>



Our work has confirmed that the Council and Pension Fund’s organisational and IT control environments are designed effectively and provided assurance that the environments support the production of materially correct financial statements.

### Work completed

Controls operated at an organisational level often have an impact on controls at an operational level. Weaknesses in the overall organisational level are often pervasive through the financial statements, and this would have implications for our audit.

We obtained an understanding of the Council and Pension Fund’s organisational control environments and evaluated whether these controls have been designed effectively.

The Council and Pension Fund 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.

The Council and Pension Fund introduced a new financial system from the beginning of the 2015/16 financial year. We identified this as a specific audit risk in our Audit Plan, and undertook specific work on the implementation of this new system, including the transfer of balances from the old to the new system.

### Key findings

Based on our testing undertaken we have gained assurance that the Council and Pension Fund organisational and IT control environments are designed effectively to support the production of financial statements that are free from material mis-statement. The table on this page summarises our results over each element of the environment.

Our testing on the implementation of the new financial system has provided assurance that:

- Balances were transferred completely and accurately from the old financial system to the new system; and
- No other significant issues have been identified that impact on the material accuracy of the Council or Pension Fund financial statements.

Aspect	Assessment
<b>Organisational controls:</b>	
Management 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
<b>IT controls:</b>	
Password parameters	3
Control over ‘Super Users’	3
Control over user access	3
Change control procedures	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 - Council



Our testing of relevant controls we identified in relation to payroll, business rates income and council tax income provided assurance over the material correctness of the transactions.

Our testing of the bank reconciliation process identified that the controls could be strengthened by implementing a clearly documented management review of the completed monthly reconciliation.

## Work completed

Where we have determined that this is the most efficient audit approach to take, we identify relevant financial systems, evaluate the design and implementation of key controls that address key risks within these systems and then test these controls. The results from this work informs our substantive testing which we complete during our final audit visit.

Our assessment of a system will not always be in line with your internal auditors' opinion on that system. This is because our focus is solely on the controls to prevent and detect material errors in the financial statements.

## Key findings

Based on the work undertaken to date, our testing has provided assurance that the majority of the key controls in the systems tested would support the production of material correct financial statements. The table on this page summarises our assessment.

Our testing of the controls over the Council's cash and bank balance focuses on the bank reconciliation process. Our testing covered the Council's reconciliations of its County Fund, Resourcelink and General accounts.

During our work, officers brought to our attention some issues they had identified with the County Fund reconciliation, following the implementation of new cash collection systems in October 2015. These changes led to issues with the automated matching of income received to the correct general ledger code, resulting in a large backlog of unmatched items. Following extensive work by officers over the last few months of the financial year, this issue has now been fully resolved. Our review of the March 2016 reconciliation while we were on site confirmed that the backlog of unmatched items had now been cleared.

Our review of the controls operating over the bank reconciliation process identified that the controls could be strengthened by

implementing a clearly documented management review of the reconciliation and evidencing both the preparation and review of the reconciliation.

No weaknesses were identified from our testing of the relevant controls we identified in relation to payroll, business rates income and council tax income.

We have not yet assessed the controls over the Council's pension liabilities and property plant and equipment balances. The key controls in respect of these areas are operated during the closedown process and our testing will be carried out during our final audit visit.

For the Council's non-pay expenditure, our approach is to gain assurance by undertaking detailed data and analytics work to substantively test the entire population, rather than undertake controls testing.

Financial system	Assessment
Property, Plant and Equipment	TBC
Cash and Cash Equivalents	2
Pension Assets and Liabilities	TBC
Non pay expenditure	N/A
Payroll	3
Business rates income	3
Council tax income	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 – Pension Fund



Our testing of relevant controls we identified in relation to investment assets, benefits payable and contributions receivable provided assurance over the material correctness of the transactions.

We were unable to complete our testing of the Pension Fund bank reconciliation as the information we required had not been provided by officers at the time of our visit.

## Work completed

Where we have determined that this is the most efficient audit approach to take, we identify relevant financial systems, evaluate the design and implementation of key controls that address key risks within these systems and then test these controls. The results from this work informs our substantive testing which we complete during our final audit visit.

## Key findings

Based on the work undertaken to date, our testing has provided assurance that the majority of the key controls in the systems tested would support the production of material correct financial statements. The table on this page summarises our assessment.

No weaknesses were identified from our testing of the relevant controls we identified in relation to:

- Investment assets;
- Benefits payable; and
- Contributions receivable.

For the investment assets and contributions receivable systems, a year end reconciliation to the general ledger is undertaken as part of the pension fund closedown procedures. We will therefore review and test these reconciliations in detail as part of our audit work on the financial statements.

We have not yet completed our controls testing over the Pension Fund cash and bank balances. We have discussed the processes in place with officers, but have not been provided with copies of completed reconciliations that we need to undertake our testing.

We will review and test the year end bank reconciliation along with the in-year reconciliations in detail during our final audit visit.

Financial system	Assessment
Cash and Cash Equivalents	TBC
Investment assets	3
Benefits payable	3
Contributions receivable	3

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



# Other financial controls and processes – Council and Pension Fund



**Our testing of the Council's budget setting and monitoring process provided assurance that material errors would be detected and corrected.**

**Our testing of the controls operating over the Council and Pension Fund journal transfers identified that there is no independent authorisation of journals, and that all officers with relevant access can post and authorise journals of any value.**

## Work completed

The Council and Pension Fund rely on other key financial controls to provide assurance over the integrity and completeness of the data in its financial systems. These controls include its monitoring of spending against the budget and restrictions around the use of adjustment journals within the general ledger.

As part of our procedures we review both of these areas.

- For journals this involves understanding and testing the controls over journal entry and review/authorisation.
- For budget monitoring, we test the key controls that operate over setting the budget and monitoring and reporting the corresponding spending.

## Key findings

### Journals – Council and Pension Fund

Due to officer availability during our interim visit, we were not able to obtain a listing of journal transfers in order to complete our testing.

From our evaluation of the controls in place, we have identified a weakness in the controls over journal authorisation which increases the risk that incorrect journal transfers are processed, leading to material errors in the financial statements.

There is no independent authorisation of journal transfers. The Council's process is that the creator of the journal inputs and approves the transfer themselves. In addition all officers with the relevant access to the general ledger system can create and post journals of any value, as there is no 'value hierarchy' built into the system.

Officers consider that the monitoring and reporting of spending against the budget provides a compensating control, and officers have reported that all journals with a value of over £3m will be reviewed at the year end to provide additional assurance.

Where controls are found to be operating effectively, our audit approach to journal transfers focuses on the year-end closedown journals. However, the impact of the weakness in the Council's journals control framework is that we will need to carry out more substantive testing of the journals processed during the year to provide assurance over the material accuracy of the journal transfers. This work will be completed during our final audit visit.

### Budgetary Control - Council

Following the implementation of the new financial system, the Council has begun implementing developed financial management arrangements during 2015/16. Budget holders are able to, and are encouraged to, access real-time budget and spending data whenever they need to, enabling a self-service approach to budget monitoring. At the time of our review this process was still being embedded, and training on this system functionality was still being provided.

Established timetables are in place for reporting spending against budgets at service, directorate and council level which enable regular and routine challenge and accountability.,

From our testing we are content that the setting of the Council's budget, and the monitoring and reporting of spending against the budget through the year provides assurance to us that material errors in the financial statements would be identified and corrected.

Financial control/ process	Assessment
Journal processes	2
Budgetary Control	3

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

# Audit requirements and accounts production process and risk assessment – Council and Pension Fund

Our review and testing of the Council's overall process for preparing the financial statements provides assurance that the process is effectively designed, and likely to produce financial statements that are materially correct.

### Audit requirements and accounts production process

We issued our interim 'Prepared by Client' working paper requests for the Council and the Pension Fund in February and March respectively. These documents set out our audit approach and timetable. They also summarise the working papers and other evidence we require the Council and Pension Fund to provide to support our audit work.

We will issue separate requests for the working papers we require officers to provide for our year end final accounts visit.

During our interim visit we documented our understanding of the Council and Pension Fund accounts production process, including a review of the closedown procedures and timetable for the 2015/16 statement of accounts.

### Key findings

The 'Prepared by Client' request is new to Council officers, but we are happy with how it has been received. Although at our interim visit some working papers were not available and the corresponding audit work was not completed, the majority of the papers were presented, and we have established a good positive working relationship with the Council finance staff.

We believe it will contribute to an efficient audit of the financial statements, minimising the disruption of Council finance staff from the final audit processes.

From our review of the Council closedown procedures and its plan to produce the financial statements we are satisfied that there are no issues to raise. Although the accounting requirements for 2015/16 do not contain significant changes from 2014/15, this will be the first year of closing down the new financial system and producing a trial balance, and this presents additional challenges for the Council.

During this first year of our audit appointment we expect there to be differences in our approach to your previous auditor, and we are working to also obtain a better understanding of your working practices, to ensure that future audits are effective and streamlined and minimise disruption to the Council finance staff.

We will continue to discuss the audit process with officers, including a post-final audit meeting with key finance staff, to determine what lessons can be learnt and improvements made where necessary for the following year's audit.

# Specific audit risk areas – Council and Pension Fund



The Council and Pension Fund have a good understanding of the key audit risk areas we identified and are making progress in addressing them.

We will revisit these areas during our final audit visit.

### Financial statements risks

In our External Audit Plan 2015/16, presented to you in February, we identified the key audit risks affecting the Council's 2015/16 financial statements. These are as follows:

- New financial systems (Council and Pension Fund); and
- Impairment of PPE due to flooding (Council only).

### Work completed

Our audit strategy and plan remain flexible as risks and issues change throughout the year. To date, based on our discussions and audit work, there are no changes to the risks previously communicated to you.

We have been discussing these two risk areas with officers as part of our regular meetings. In addition, we sought to review relevant workings and evidence and agree the accounting treatment as part of our interim work.

### Key findings

#### New financial system

We have discussed in detail the processes that the Council and Pension Fund undertook to plan for, and then introduce, the new financial systems.

The practical implementation is still ongoing as the Council and Pension Fund continue to introduce devolved real-time budget monitoring, and plan to implement a new accounts payable process during 2016/17.

Our IT audit work reported on page 6, and our other enquiries, have not identified any issues to date, and we are satisfied that we have the assurance we had planned for, that the new system will

support financial statements that are free from material errors.

### Impairment of PPE due to flooding

Our work to date has confirmed that the Council's infrastructure assets are correctly held at historical cost and depreciated.

An assessment of impairments is carried out at the year end, but the Council has reported to us during our interim visit that the damage to properties and infrastructure due to the flooding in December 2015 has been minimal, and mostly affects roads and bridges. A working paper summarising the costs associated with the flood damage to infrastructure will be prepared as part of the year end closedown procedures.

Our work on the Council's impairment considerations any consequential impact on the financial statements will be concluded at our final audit visit.

The Council is content that all affected assets are insured, and it expects any financial impact to the Council to not be significant. Officers have reported that they are aware that funding is available for costs associated with flooding from the central government Bellwin scheme, subject to relevant thresholds applied to each event.

# VFM audit approach



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

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

Our *External Audit Plan 2015/16* describes in more detail how the VFM audit approach operates.

## Background to approach to VFM work

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

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

The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial

resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria.

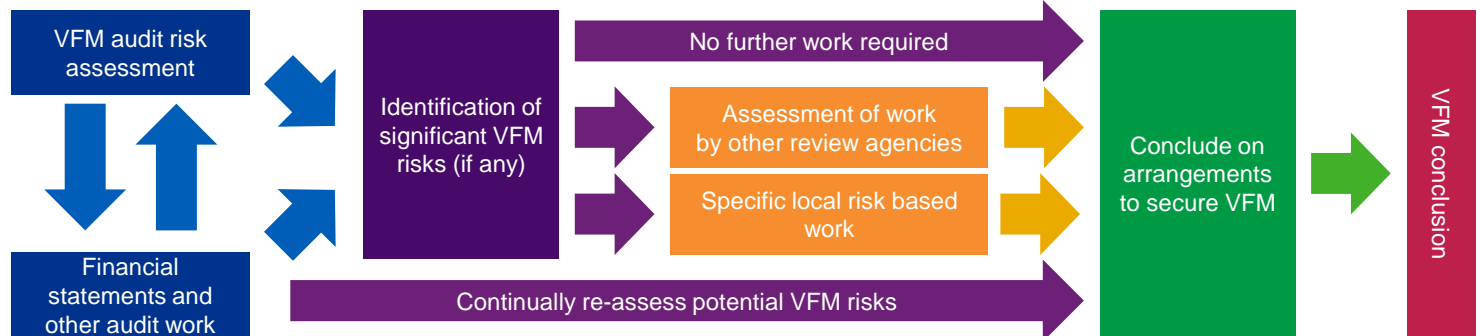
These sub-criteria provide a focus to our VFM work at the Council.

## Overview of the VFM audit approach

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

**Overall criterion**

In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.



## Section four – VFM conclusion

# Specific VFM risks

We have completed our VFM conclusion risk assessment work and have not identified any specific significant VFM risks.

We will revisit that assessment work during our final audit visit to ensure that our conclusions remain valid.

### Work completed

In line with the risk-based approach set out on the previous page, we have

- Assessed the Council'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 Council, other inspectorates and review agencies in relation to these risk areas; and
- Concluded to what extent we need to carry out additional risk-based work.

### Key findings

We have completed our initial VFM risk assessment and have not identified any key issues.

In concluding on the absence of any significant risks we have taken into account the Council's response to the financial challenges that it faces, including the North Yorkshire 2020 council plan, and the progress with the recent Local Government Association peer review.

We will update our assessment throughout the year.

We will report our final conclusions in our *ISA 260 Report 2015/16* at the conclusion of our audit.

# Key issues and recommendations

We have raised two recommendations from our work.

The Council has accepted one recommendation and reports that it has addressed that weakness with immediate effect. The Council is satisfied that a compensating control mitigates the risks presented by the second recommendation and we have accepted this response.

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

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

We will formally follow up implementation of our recommendations next year.

Priority rating for recommendations		
<p><b>1</b> <i>Priority one:</i> 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.</p>	<p><b>2</b> <i>Priority two:</i> 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.</p>	<p><b>3</b> <i>Priority three:</i> 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.</p>

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
1	2	<p>Although through discussion with officers we are satisfied that bank reconciliations for the main Council bank accounts are being regularly undertaken, there was a lack of documented sign-offs to demonstrate the preparation and review during 2015/16.</p> <p>Each bank reconciliation undertaken should include a prepared by and reviewed by sign off that is dated by the relevant officers.</p>	<p><b>Management Response</b> Reviews will be evidenced with immediate effect.</p> <p><b>Responsible officer</b> Senior Accountant – Statutory Accounts</p> <p><b>Due date</b> Immediately</p>
2	2	<p>All officers with the relevant access to the general ledger system can create and post journals of any value as there is no value hierarchy built into the system. There is no segregation of duties in the creation and posting of journals</p> <p>A hierarchy should be included within the general ledger and officers limited to the value of journals they can enter and approve.</p> <p>All adjustment journals should be independently authorised by a finance officer.</p>	<p><b>Management Response</b> We believe that the monitoring of spending against the budget is a suitable compensating control to ensure all material issues are identified and therefore no further action is proposed.</p>



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