ITEM 5

External Audit Report 2015/16

North Yorkshire County Council

North Yorkshire Pension Fund

—

September 2016

Contents

The contacts at KPMG in connection with this report are:

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

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Rashpal Khangura, the engagement lead to the Council, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers (on 0207 694 8981, or by email to andrew.sayers@kpmg.co.uk). After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3H.

Section one: Introduction

Introduction

This document summarises:

- **The key issues identified during our audit of the financial statements for the year ended 31 March 2016 for both the Council and its pension fund; and**
- **Our assessment of the Council's arrangements to secure value for money.**

Scope of this report

This report summarises the key findings arising from:

- Our audit work at North Yorkshire County Council ('the Council') in relation to the Council's 2015/16 financial statements and those of the North Yorkshire Pension Fund it administers ('the Fund'); and
- The work to support our 2015/16 conclusion on the Council's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

Financial statements

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

Planning → Control Evaluation → Substantive Procedures → Completion

We previously reported on our work on the first two stages in our *Control Framework Report 2015/16* issued in June 2016.

This report focuses on the third stage of the process: substantive procedures. Our on site work for this took place during July and August 2016.

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

VFM Conclusion

Our External Audit Plan 2015/16 explained our risk-based approach to VFM work and we included the findings from our planning work in our *Control Framework Report 2015/16*. We have now completed the 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; and
- considering the results of any relevant work by the Council and other inspectorates and review agencies in relation to these risk areas.

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 audit work in relation to the 2015/16 financial statements of the Council and the fund.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix One. We have also reviewed your progress in implementing prior recommendations.

Acknowledgements

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

Section two: Headlines

Headlines

This table summarises the headline messages for the Council and the Fund. Sections three and four of this report provide further details on each area.

This table summarises the headline messages. Sections three and four of this report provide further details on each area.

Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Council's financial statements by 30 September 2016. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007. We also anticipate issuing an unqualified audit opinion in relation to the Fund's financial statements, as contained both in the Council's Statement of Accounts and the Pension Fund Annual Report by 30 September 2016.
Audit adjustments	Our audit identified a number of audit adjustments in excess of our reporting threshold of £750,000. The Council has amended all of these except one relating to the cash flow statement for which it does not have the relevant information. None of these adjustments impacted on the general fund balance, the surplus on provision of services, or the net worth of the Council. We have included a list of the significant audit adjustments at Appendix two detailed the background to, and impact of, each of them. We have raised three recommendations in relation to the matters identified from the audit, and these are reported in Appendix one.
Key financial statements audit risks	We review our identified risks to the financial statements on an ongoing basis. We identified the following significant financial statements audit risks in our 2015/16 External Audit Plan issued in February 2016. — New financial system, implemented from 1st April 2015; and — Accounting impact of the flooding in the county in December 2015. We have worked with officers to understand the impact of these risks and our detail findings are reported in section 3 of this report. There are no matters of any significance arising as a result of our audit work in these key risk areas.

Headlines (cont.)

This table summarises the headline messages for the Council and the Fund. Sections three and four of this report provide further details on each area.

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

Accounts production and audit process	We received complete set of draft financial statements on 29 June 2016 in accordance with the DCLG deadline. Other than presentational changes that were made following the audit, the accounting policies, accounting estimates and financial statement disclosures were in line with the requirements of the Code. Given that this was the first year of our audit, and hence we had no cumulative knowledge to inform our audit, the impact on Council officers has understandably been greater than will be the case in the second and subsequent years of our audit. Nonetheless, it is pleasing to report that the relationship we have established has been very positive, and officers have produced good quality supporting working papers, and dealt efficiently with our numerous audit queries, enabling us to complete the audit process within the planned timescales. The Council has changed the personnel and the finance structure since the previous year-end. Although this has presented challenges through the audit, it is pleasing to report that this has not impacted on the quality of the working papers or the responses to our queries. We will hold a debrief meeting with the finance team to share views on our first year of audit and to learn lessons that will lead to further efficiencies in the 2016/17 closedown and audit processes. We would like to thank council officers who were available throughout the audit visit to answer our queries.
VFM conclusion and risk areas	We completed our planning process in spring 2016 and reported our conclusions in our Control Environment Report 2016 issued in June 2016. This reported that we had not identified any significant risks to our VFM conclusion. We have updated our work at the year end, and have not identified any new significant risks as a result of this update. There are no matters of any significance arising as result of our audit work in these VFM risk areas. We have consequently concluded that the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources, and we therefore anticipate issuing an unqualified VFM conclusion by 30 September 2016.

Headlines (cont.)

This table summarises the headline messages for the Council and the Fund. Sections three and four of this report provide further details on each area.

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

Completion	At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas: — Whole of Government Accounts audit work; — Completion of testing on post balance sheet events; and — Resolution of queries on - SERCoP disclosures, and - contingent liabilities. You are required to provide us with representations on specific matters such as your going concern assertion and whether the transactions in the accounts are legal and unaffected by fraud. We provided a draft of this representation letter to the Section 151 Officer on 26 August 2016. We draw your attention to the requirement in our representation letter for you to confirm to us that you have disclosed all relevant related parties to us. We have not asked management to provide any additional and specific representations. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Council's financial statements.

Section three: Financial Statements

Proposed opinion and audit differences - Council

We have not identified any issues in the course of the audit that are considered to be material.

Following the audit, the Council has made a number of adjustments to the draft financial statements.

None of the adjustments impacted on:

- **the balance on the general fund account at 31 March 2016;**
- **the deficit on the provision of services for the year; or**
- **the net worth of the Council as at 31 March 2016.**

The wording of your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Council's financial statements following approval of the Statement of Accounts by the Audit Committee on 29 September 2016.

Audit differences

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

The final materiality level (see Appendix Three for more information on materiality) for this year's audit was set at £15 million. Audit differences below £750,000 are not considered significant.

Our audit identified a number of significant audit differences, which we set out in Appendix Two. It is our understanding that these will be adjusted in the final version of the financial statements with the exception of one adjustment to the cash flow statement. In this case the Council is unable to identify the required entries without significant additional manual input, and as it does not materially misstate the financial position of the Council, it has determined to not undertake that additional work for 2015/16. Full details are included in Appendix Two.

The tables on the right illustrates that the adjustments made had no impact on the Council's movements on the General Fund for the year and balance sheet as at 31 March 2016.

The adjustments are set out on the next page and Appendix Two.

Annual governance statement

We have reviewed the Council's 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.

Movements on the general fund 2015/16

£'000	Pre-audit	Post-audit
Deficit on the provision of services	31,996	31,996
Adjustments between accounting basis and funding basis under Regulations	(44,220)	(44,220)
Transfers to earmarked reserves	76,665	76,665
Decrease in General Fund	**64,441**	**64,441**

Balance sheet as at 31 March 2016

£'000	Pre-audit	Post-audit
Property, plant and equipment	1,507,699	1,507,699
Other long term assets	69,432	69,432
Current assets	361,784	361,784
Current liabilities	(146,672)	(146,672)
Long term liabilities	(764,967)	(764,967)
Net worth	**1,027,276**	**1,027,276**
General Fund	(27,270)	(27,270)
Other usable reserves	(219,847)	(219,847)
Unusable reserves	(780,159)	(780,159)
Total reserves	**(1,027,276)**	**(1,027,276)**

Proposed opinion and audit differences - Council (cont.)

We have not identified any issues in the course of the audit that are considered to be material.

Following the audit, the Council has made a number of adjustments to the draft financial statements.

None of the adjustments impacted on:

- **the balance on the general fund account at 31 March 2016;**
- **the deficit on the provision of services for the year; or**
- **the net worth of the Council as at 31 March 2016.**

The wording of your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.

Of the other audit adjustments we have identified, the most significant in monetary value are as follows:

- Bentham New School, valued at £6 million, which opened and became operational in February 2016, had been included in Assets under Construction within the Property, Plant & Equipment balance, rather than transferring it to Operational Land & Buildings. This adjustment did not impact on the overall value of Property, Plant & Equipment; and
- Adjustments of £3 million were made to the Cash Flow Statement to accurately report the cash and non-cash adjustments, and comply with the CIPFA Code.

During our audit, the Council identified some significant adjustments itself and has amended the relevant notes to the accounts accordingly. We have included these adjustments in Appendix Two for completeness.

In addition, we identified a number of presentational adjustments required to ensure compliance with the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 ('the Code'). We understand that the Council has addressed these issues.

Proposed opinion and audit differences - Pension Fund

We have identified no issues in the course of the audit of the Fund that are considered to be material.

We anticipate issuing an unqualified audit opinion in relation to the Fund's financial statements, as contained both in the Council's Statement of Accounts and the Pension Fund Annual Report by 30 September 2016.

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Fund's financial statements, both in the Council's financial statements and the Pension Fund Annual Report, following approval of the Statement of Accounts by the Audit Committee on 29 September 2016.

Pension fund audit

Our audit of the Fund did not identify any material misstatements.

For the audit of the Fund we used a materiality level of £25 million. Audit differences below £1.25 million are not considered significant.

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion following approval of the Statement of Accounts by the Audit Committee on 29 September 2016.

We did not identify any significant audit adjustments required to the Pension Fund accounts, and the tables on the right confirm that the minor adjustments made have not impacted on the Increase in the Fund Account for the year or the value of Net Assets at the year end.

Our audit testing identified one matter to report to you relating to the Fund's treatment of benefits payable around the end of the financial year. The Fund accounts for benefits payable on a cash basis rather than accruing benefit liabilities which are due at the year end but not yet paid. This issue was reported last year by the Fund's previous auditors, and we have not included any specific recommendations or actions for the Fund as a result.

The benefits paid after 31st March 2016 which should have been accrued into 2015/16 were £836,000. This amount is below our significant differences threshold, and we have not required the amount to be corrected in the accounts. The corresponding figure reported by the previous auditors last year was £608,000.

Pension fund annual report

We have reviewed the Pension Fund Annual Report and confirmed that the financial and non-financial information it contains is not inconsistent with the financial information contained in the audited financial statements.

We anticipate issuing an unqualified opinion on the Pension Fund Annual Report at the same time as our opinion on the Statement of Accounts.

The statutory deadline for publishing the Annual Report is 1 December 2016. Should we not be able to sign our report on the Annual Report at the same time we would need to complete additional work in respect of subsequent events to cover the period between signing our opinions on the Statement of Accounts and the Pension Fund Annual Report.

Movements on the Fund Account 2015/16

£'000	Pre-audit	Post-audit
Contributions and transfers in	120,368	120,368
Benefits and other expenses	(104,528)	(104,528)
Net returns on investments	2,124	2,124
Increase in the Fund	**17,964**	**17,964**

Net Assets as at 31 March 2016

£'000	Pre-audit	Post-audit
Investment assets	2,420,068	2,420,068
Investment liabilities	(10,771)	(10,771)
Net investment assets	**2,409,297**	**2,409,297**
Current assets	12,295	12,295
Current liabilities	(3,759)	(3,759)
Total Net Assets	**2,417,833**	**2,417,833**

Significant audit risks

We have worked with the Council throughout the year to discuss significant risks and key areas of audit focus.

This section sets out our detailed findings on those risks.

In our *External Audit Plan 2015/16*, we identified the significant risks affecting the Council's 2015/16 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

The tables below and on the next page set out our detailed findings for each of the risks that are specific to the Council.

New Financial System (Council and Pension Fund)

— Risk

The Council and Pension Fund financial systems have been replaced during 2015/16, with a new general ledger system in place from the start of the financial year.

The implementation of a new system and the transfer of balances between systems are not routine processes, and therefore represent a significant risk to our opinion on the 2015/16 financial statements.

— Findings

We reviewed the processes the Council had in place to implement the new financial system and we tested the Council's data transfer procedures from the old financial system closing balances to the opening balances in the new financial systems.

Our testing confirmed that the new system was implemented according to the Council's plan, and that the balances were completely and accurately transferred to the new system.

Significant audit risks (cont)

We have worked with the Council throughout the year to discuss significant risks and key areas of audit focus.

This section sets out our detailed findings on those risks.

In our *External Audit Plan 2015/16*, we identified the significant risks affecting the Council's 2015/16 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

The tables below sets out our detailed findings for each of the risks that are specific to the Council.

Impairment of PPE due to flooding (Council only)

— Risk

The flooding in December 2015 caused a high degree of damage in North Yorkshire and this might impact in the 2015/16 financial statements. The damage may have caused significant material impairment to some Council assets.

The Council's assessment of the impairment value involves significant judgement and estimation, and will likely involve the use of a valuation expert. This impairment could have a material impact on the financial statements.

— Findings

The Council has identified that there are impairments required to the 2015/16 asset values for the flooding. In particular the damage, and respective repair to Tadcaster Bridge. The Council has estimated that the capital cost of repair is £3 million.

In calculating the impairment required, the Council has, consistent with its annual impairment assessment, discounted the repair costs using the infrastructure (FOCOS) indices. This has determined that the overall infrastructure impairment, which includes the flooding damage, to be £1.1 million.

We are content that the Council has evaluated the need for impairments, has calculated them in a consistent manner with its normal infrastructure impairment assessments, and made appropriate accounting entries to impair the assets.

In addition we have confirmed that the estimate of the repair value was based on professional valuer estimates, is consistent with that reported to the Council, and that the current cost of the work to the end of August provides further evidence that the cost estimate, and hence the value of the impairment is materially correct.

Significant audit risks (cont)

We have worked with the Council throughout the year to discuss significant risks and key areas of audit focus.

This section sets out our detailed findings on those risks.

In our *External Audit Plan 2015/16* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. These risk areas were Management override of controls and the Fraud risk of revenue recognition.

The table below sets out the outcome of our audit procedures and assessment on these risk areas.

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Fraud risk of revenue recognition

Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.

In our External Audit Plan 2015/16 we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue.

This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.

Management override of controls

Professional standards require us to communicate the fraud risk from management override of controls as significant because management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

Our audit methodology incorporates the risk of management override as a default significant risk. We have not identified any specific additional risks of management override relating to this audit.

In line with our methodology, we carried out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business or are otherwise unusual.

There are no matters arising from this work that we need to bring to your attention.

Accounts production and audit process

This is our first year of the Council's audit and we have used this year's audit to establish our knowledge of the Council's accounts and accounting practices.

We have worked closely with Council and Pension Fund officers to try and ensure a smooth transition from your previous auditors.

Officers provided good working papers to support our audit, and dealt efficiently with our audit queries.

We will discuss improvements to the audit process and the Council's closedown process as part of our early planning for 2016/17 at the conclusion of this year's audit.

Accounts production and audit process

ISA 260 requires us to communicate to you our views about the significant qualitative aspects of the Council's and the Fund's accounting practices and financial reporting. We also assessed the Council'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	Our first year audit has not identified any significant weaknesses with the Council's financial reporting process. We consider that accounting practices are generally appropriate, although we have reported some elements of the cash flow statement were not compliant with the Code requirements, and the consideration of related party transactions needs to consider whether transactions are material from both the Council and the related party perspective.
Completeness of draft accounts	We received a complete set of draft accounts on 29 June 2016. The Whole of Government Accounts submission was delayed, and we received this on 2 September 2016. The guidance and reporting pack from DCLG was delayed in being issued, and this contributed to the Council not being able to provide this earlier.
Group audit	To gain assurance over the Council's group accounts, we carried out work on the consolidation process. There are no specific matters to report pertaining to the group audit.
Quality of supporting working papers (continued)	Our *Accounts Audit Protocol* sets out our working paper requirements for the audit. We issued this on 8th June and discussed with finance officers before the start of the audit. Given that this was the first year of our audit, and we had no cumulative knowledge to inform our approach, the impact on Council officers has understandably been considerable. It is pleasing to report that the relationship we have established has been very positive, and officers have produced good quality supporting working papers to assist us. The quantity of the working papers we have requested has been more than might be necessary in subsequent years when we have significant cumulative knowledge. Consequently, although officers adapted well to our audit requirements, some working papers were only provided later on in the audit process.
Response to audit queries	Officers resolved our audit queries in a reasonable time. In some cases, however, we experienced delays, specifically where staff who prepared the working papers were not available during the audit. These delays did not cause a significant impact on the audit, and is understandable given the audit taking place during July and August.

The challenge for the Council in future years is to ensure that it can produce its accounts earlier to meet the requirements of the Accounts & Audit Regulations in 2017/18, while maintaining a focus on appropriate and compliant accounting practices.

As part of our audit completion processes we will provide finance officers with our observations on improvements that can be made to deliver improvements in financial reporting in the shorter timeframe.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Council'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 North Yorkshire County Council and North Yorkshire Pension Fund for the year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and the Council and the Pension Fund, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix Three 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 Strategic Director – Corporate Resources for presentation to the Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

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

- Significant difficulties encountered during the audit;
- Significant matters arising from the audit that were discussed, or subject to correspondence with management;
- Other matters, if arising from the audit that, in the auditor's professional 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 (for example significant deficiencies in internal control, issues relating to fraud, compliance with laws and regulations, subsequent events, non-disclosure, related parties, public interest reporting, questions or objections, or opening balances).

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report.

Section four: Value for Money

VFM Conclusion

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

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

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

Background

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the Council '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.

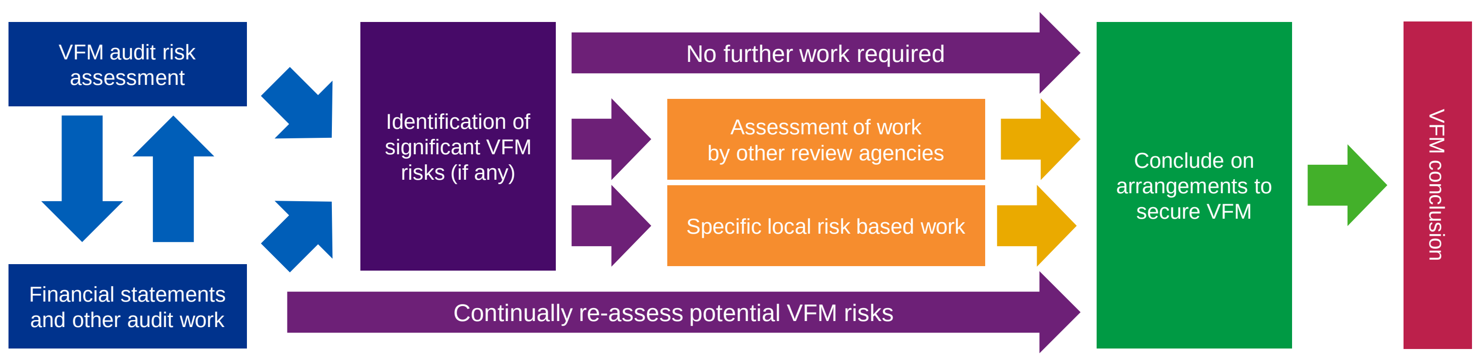
Conclusion

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

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.

Informed decision making	Sustainable resource deployment	Working with partners and third parties
✓ Met	✓ Met	✓ Met



Specific VFM Risks

Having carried out our detailed planning work, we did not identify any significant VFM conclusion risks.

Our detailed planning work considered, among other areas, the Council's approach to medium term financial planning, its partnership working with other public services, and the findings from the LGA Peer Challenge review.

Work completed

In line with the risk-based approach set out on the previous page, and in our *External Audit Plan* 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; and

— Considered the results of relevant work by the Council, inspectorates and review agencies in relation to these risk areas.

Key findings

Having completed our detailed planning work, we reported in our Control Environment Report 2015/16 in June 2016, that we had not identified any significant risks to our VFM conclusion.

In concluding this, we considered the following key elements:

— The Council's approach to medium term financial planning. The 2020 North Yorkshire Council Plan sets out the Council's strategy for delivering against the significant financial challenges. These challenges are reported and monitored in the corporate risk register and the Council is clearly devoting significant resources to putting in place mitigating arrangements to manage those risks. From our review we are satisfied that the Council has arrangements in place to respond to these challenges, and we have no issues to report.

— The Council's approach to partnership working. This year has seen the start of the Better Care Fund, with the required close working between the Council and local NHS organisations. Governance arrangements. The Council has understood the challenges, and has managed the risks and issues related to the close partnership working through the year. While there are significant challenges for the Council in 2016/17 and beyond, particularly in dealing with a wide range of NHS commissioners and providers, we are satisfied that the Council's arrangements to manage these challenges are appropriate and adequate.

— LGA Peer Review. In March 2015/16 the Local Government Association carried out a Corporate Peer Challenge for the Council. The findings from this review confirmed that the Council delivers highly regarded services with examples of excellence throughout its operations. The report is positive and although it identifies a number of considerations for the Council, these are all areas that it is already focusing on, such as developing the partnership arrangements across other public services, focusing beyond 2020, and developing its business development/commercial strategy. We are satisfied from our review of the findings that this work confirms that the Council has adequate arrangements in place to deliver value for money in its use of resources.

VFM – 2015/16 outturn

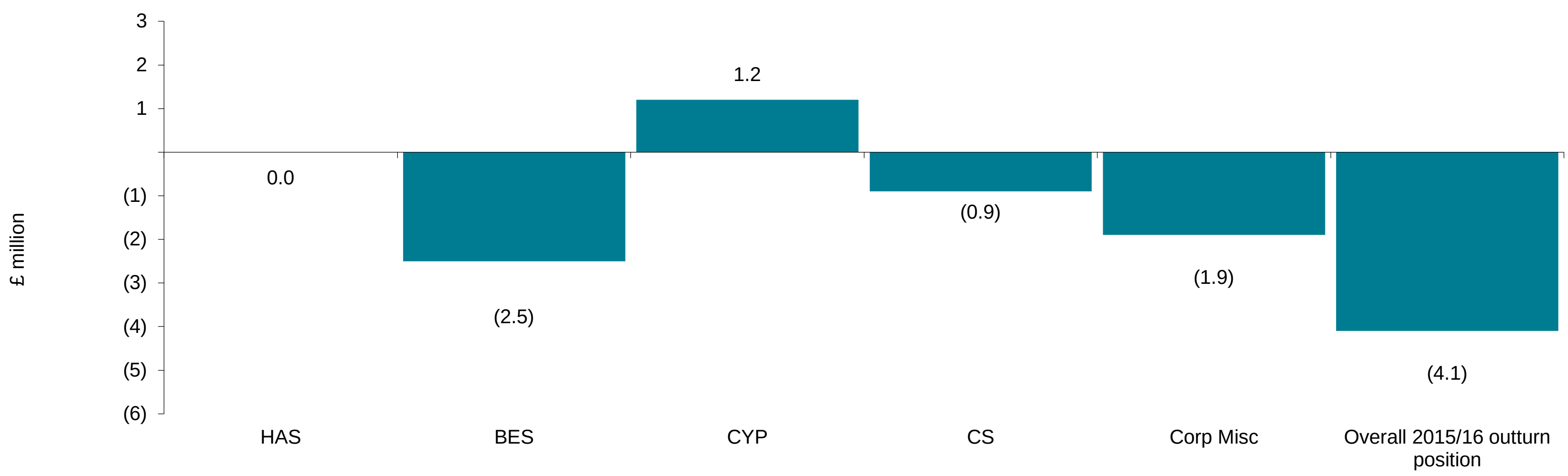
2015/16 outturn

In considering the Council's arrangements for securing financial resilience, we reviewed the outturn position against original plans, as well as identifying any specific one-off transactions to identify the normalised position 2015/16.

The Council set an overall net revenue expenditure budget for 2015/16 of £389.86 million. This represented a £10 million reduction from the respective budget in 2014/15. The operational budget for the Council departments, excluding the 'Pending Issues Provisions', was £365.52 million. The Council delivered an underspend against this budget of £4.1 million. This Council has reported that the underspend was predominantly achieved through one-off savings and windfalls of £3.4 million, with a significant amount of early achievement of savings planned for future years. Within the actual spending were some reported overspends, for example, Children and Young People's Services continues to experience financial challenges relating to demand pressures and the costs of an increasing number of complex cases, along with pressures on home to school transport, and despite delivering some early savings in some areas, the service reported an overspend of £1.1 million. The financial impact of the flooding in the county December 2015 has fallen on the 2015/16 financial year and this unbudgeted revenue cost was reported to be £0.8 million.

The Council's approach to its General Fund balance is to plan to maintain a level of 2% of net revenue budget plus £20 million. In 2015/16 this level was achieved, and the Council has transferred £36 million in 2015/16 to a newly established Strategic Capacity Reserve. This reserve is to support the medium term financial strategy in 2016/17 and future years, and the Council's financial plans indicate that this reserve will be predominantly utilised in the period up to 2019/20.

2015/16 reported outturn position compared to budget by Council department



VFM - Planned 2016/17 budget

Planned 2016/17 budget

The Council's net expenditure budget for 2016/17 is £360.57 million. The budget for 2016/17 includes the use of £3.3 million of General Fund working balances.

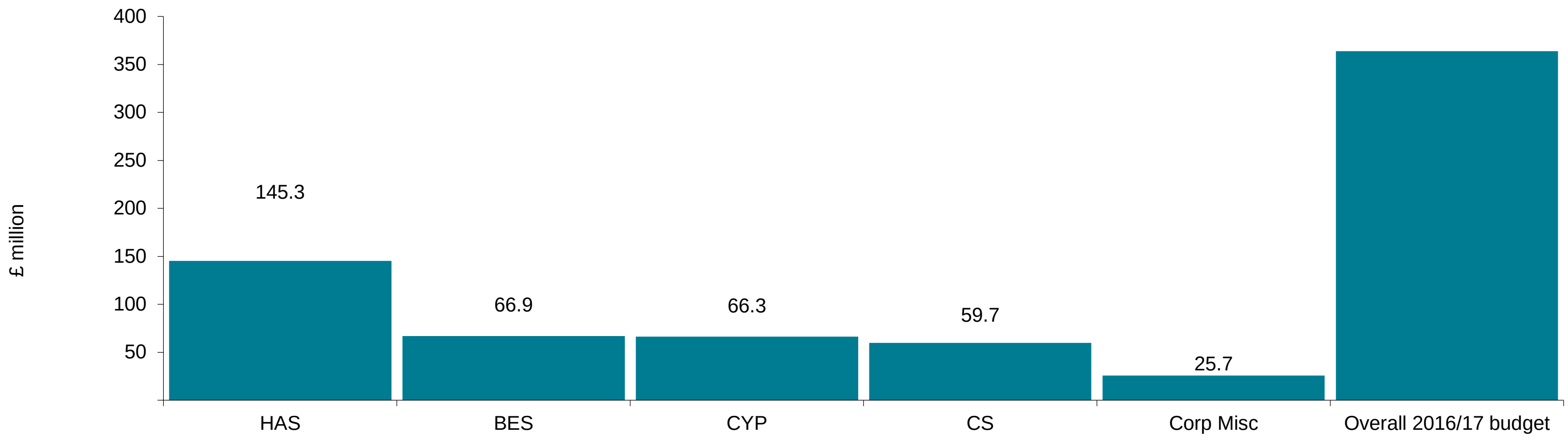
The first quarter monitoring report shows that the Council is projecting an underspend against this budget of £5 million, but within this projection are some significant service cost pressures. In particular there are pressures being reported in:

— Children and Young People's Service, as in 2015/16, with demand-led pressures and home to school transport

— Health & Adult Services, with demand-led pressures across care and support budgets

Offsetting these pressures are underspends in corporate and centrally held budgets, which, if achieved at the year end, will enable the Council to supplement its reserves to assist in delivering the financial challenges for 2017/18 and beyond.

2016/17 net expenditure budget



Appendices

Key issues and recommendations

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 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	**Cash flow statement – capital debtors and creditors** The Council has updated its ledger coding structure in 2015/16 and has not retained separate capital ledger codes. Consequently it has been unable to identify the capital debtors and creditors, required for compliant completion of the cash flow statement. As the cash flow requires the movement on capital debtors and creditors from the prior year, this omission will impact on 2015/16 and 2016/17. **Recommendation** Include a method of identifying capital debtors and creditors in the 2016/17 closedown process to enable compliance with cash flow requirements from 2017/18.	**Management Response** Agreed. The specific capital debtors and creditors balance sheet codes were consolidated as part of the review of the Authority's Chart of Accounts during the upgrade of the financial ledger, which has impacted on the detail of the analysis available. As a result the report's recommendation is accepted and the specific codes will be re-instated for use during 2016/17. **Responsible Officer** Senior Accountant, Capital & Treasury Management **Due Date** 30 June 2017

Key issues and recommendations (cont)

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 these recommendations next year.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
2	2	**Assets under construction** As part of the year-end closedown processes the Council omitted to transfer an asset from Assets under Construction to Operational Land & Building. Assets under Construction are measured at Historical Cost, whereas Operational Assets are measured at either Existing Use Value or Depreciated Replacement Cost. **Recommendation** Include a process to identify the operational date of any Assets under Construction as part of the year-end closedown, and ensure that the value of any operational assets transferred in year is on the correct basis.	**Management Response** Agreed. The report's recommendation is accepted and a full review of any Assets Under Construction will be undertaken as part of the year end closedown process. **Responsible Officer** Senior Accountant, Capital & Treasury Management **Due Date** 30 June 2017
3	3	**Related party transactions** In applying the applicable financial standard, the CIPFA Code allows Councils to apply a consideration of materiality in disclosing related party transactions. It does however require that Councils consider materiality from both its own perspective and that of the related party. This might mean that a low level of transaction should be disclosed where it relates to an individual or a small business. Although it has disclosed some related party transactions of a low value, the transactions with Other Related Parties are only disclosed where they are greater than £1 million. **Recommendation** Include a consideration of materiality from both the related party and the Council's perspective in the closedown processes for all related party transactions and disclose all transactions that are considered material from either party.	**Management Response** Agreed. In line with the reports recommendation, a review of the materiality thresholds regarding related party disclosures will be undertaken in advance of the 2016/17 closedown process. **Responsible Officer** Senior Accountant, Statutory Accounts **Due Date** 30 June 2017

Audit differences

This appendix sets out the audit differences.

The financial statements have been amended for most of the errors identified through the audit process.

There is no net impact on the General Fund or the Comprehensive Income & Expenditure as a result of the amendments.

None of the adjustments to the Pension Fund statement of accounts were significant and none of the adjustments impacted on the Fund Account or Net Assets Statement.

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which in your case is the Audit Committee). We are also required to report all material misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities. As this is our first year of our audit, we have also reported the non-material audit differences which have been corrected, to assist you in fulfilling your governance responsibilities.

All the differences reported in this appendix relate to the Council's accounts and not the Pension Fund accounts. The adjustments made to the Pension Fund accounts, and the uncorrected differences in their accounts were not significant and have not been reported here.

Uncorrected audit differences

The cash flow statement contains an uncorrected difference relating to the treatment of capital debtors and creditors. Within the statement the Council should identify the movement on creditors and debtors which relate to capital transactions and present them in the 'Investing' section of the statement. In 2014/15 the Council had separate ledger codes to enable these transactions to be easily identified. However, in implementing the new ledger from 2015/16 the Council has rationalised the ledger codes, and capital codes are no longer used. The Council reports that it would require a significant amount of manual input to identify the capital debtors and creditors retrospectively, and will ensure that for 2016/17 separate codes are again used. We are satisfied based on our review of the 2014/15 transactions and the overall movement on 2015/16 debtors and creditors, that the difference would not materially affect the Council's financial statements.

Corrected audit differences

Material misstatements

Our audit did not identify any material misstatements.

Non material audit differences

Our audit identified a small number of non material errors in the financial statements. These have been discussed with management and the financial statements have been amended for all of them except for the cash flow statement difference noted above.

- Assets under Construction. An adjustment was made to move the value of Bentham New School (£6 million) from Assets under Construction to Operational Land & Buildings. The school opened in February 2016 and was therefore operational at the 31 March 2016. This adjustment did not impact on the overall Property, Plant & Equipment balance, but was a movement within Note 20 to the accounts.
- Accumulated absences. The liability relating to Accumulated Absences (£7.6 million) was included in short term Provisions as it had been in previous years. The accounting requirement for this liability is that it should be included in Short Term Creditors, and this adjustment has been made. This has not increased the overall liabilities of the Council but has increased the Creditors balance and decreased the Provisions balance in the Balance Sheet.

Audit differences (cont.)

This appendix sets out the audit differences.

The financial statements have been amended for most of the errors identified through the audit process.

There is no net impact on the General Fund or the Comprehensive Income & Expenditure as a result of the amendments.

- Cash Flow Statement. Two adjustments have been made to the Cash Flow Statement to ensure it reflects the CIPFA code reporting requirements. The first of the adjustments was to reclassify the £71.8 million of new Short Term Investments from ‘Proceeds from short term investments’ to ‘Purchase of short term investments’. The second adjustment was to reclassify capital grants which had been received in advance (£3.4 million) from the ‘Movement in Creditors’ to ‘Other receipts for investing activities’. These adjustments have not impacted on any other statement and only reclassifies amounts within the cash flow statement.
- The Council identified a small number of non-significant adjustments required during our audit. These include an adjustment wholly within the Long Term Debtors balance, an adjustment to reclassify a Short Term Creditor from General Creditors to Central Government Creditors, and an adjustment to the Council loans provided to NYNet Ltd included in the disclosures of Long Term Investments. None of these adjustments impact on any balances reported on the balance sheet or other statements.

In addition to these adjustment, following our audit, the finance team made a number of minor amendments focused on presentational improvements to the draft financial statements.

Materiality and reporting audit differences

For 2015/16 our materiality is £15 million for the Council's accounts. For the Pension Fund it is £25 million.

We have reported all audit differences over £750,000 for the Council's accounts and £1.25 million for the Pension Fund, to the Audit Committee.

Materiality

The assessment of what is material is a matter of professional judgment and includes consideration of three aspects: materiality by value, nature and context.

- Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.
- Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.
- Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We reassessed materiality for the Council following receipt of the draft financial statements, but following that reassessment, the level of materiality remained the same as we reported in our External Audit Plan 2015/16, presented to you in February 2016.

Materiality for the Council's accounts was set at £15 million which equates to around 1.5 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision, set at £10 million for 2015/16.

Reporting to the Audit Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any misstatements of lesser amounts to the extent that these are identified by our audit work.

Under ISA 260, we are obliged to report omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

ISA 450 requires us to request that uncorrected misstatements are corrected.

In the context of the Council, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £750,000 for the Council.

Where management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit Committee to assist it in fulfilling its governance responsibilities.

Materiality – Pension fund audit

The same principles apply in setting materiality for the Pension Fund audit. Materiality for the Pension Fund was set at £25 million which is approximately 1 percent of net assets.

We design our procedures to detect errors at a lower level of precision, set at £15 million for 2015/16.

Declaration of independence and objectivity

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice.

Requirements

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice (the 'Code') which states that:

"The auditor should carry out their work with integrity, objectivity and independence, and in accordance with the ethical framework applicable to auditors, including the ethical standards for auditors set by the Financial Reporting Council, and any additional requirements set out by the auditor's recognised supervisory body, or any other body charged with oversight of the auditor's independence. The auditor should be, and should be seen to be, impartial and independent. Accordingly, the auditor should not carry out any other work for an audited body if that work would impair their independence in carrying out any of their statutory duties, or might reasonably be perceived as doing so."

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 Public Sector Audit Appointments Ltd *Terms of Appointment* ('Public Sector Audit Appointments Ltd 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. Public Sector Audit Appointments Ltd 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 Engagement Lead and the audit team.

Declaration of independence and objectivity (cont.)

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

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.

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 North Yorkshire County Council and North Yorkshire Pension Fund for the financial year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and the Council and Pension Fund, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Audit Independence

Audit Fees

Our scale fee for the audit was £94,490 plus VAT for the Council and £24,943 for the Pension Fund in 2015/16). This fee was in line with that highlighted within our audit plan agreed by the Audit Committee in February 2016. During the year Public Sector Audit Appointments Ltd (PSAA) have approved additional fees of:

— £2,991 to the Council relating to the additional work we were required to carry out relating to the Council's new financial ledger system; and

— £4,996 to the Pension Fund, relating to the additional work we were required to carry out for other auditors of admitted bodies for IAS19 reporting purposes, under arrangements put in place by PSAA.

Non-audit services

We have been engaged to provide an assurance report to the Department for Transport relating to the Council's 2014/15 Major Scheme expenditure one piece of non-audit work during the year, and have summarised the fee, the potential threats to auditor independence and the associated safeguards we have put in place to manage these below.

In addition we understand the Council will engage us to provide assurance on the 2015/16 Teachers' Pension Return, and the 2015/16 Major Scheme expenditure for Department for Transport. These are also included below for completeness.

Description of non-audit service	Fee	Potential threat to auditor independence and associated safeguards in place
Provide assurance report to Department for Transport on 2014/15 Major Scheme expenditure	£3,500	The assurance report was provided having delivered a programme of work prescribed by Department for Transport. This work does not impact on the accounting in the financial statements, does not provide any assurance as part of our financial statements audit and does not involve us providing any advice to, or taking any decisions for, the Council.
Provide assurance report to Teachers' Pensions on the 2015/16 Teachers' Pensions return	£3,500 (estimated)	The assurance report will be provided having delivered a programme of work prescribed by Teachers' Pensions. This work does not impact on the accounting in the financial statements, does not provide any assurance as part of our financial statements audit and does not involve us providing any advice to, or taking any decisions for, the Council.
Provide assurance report to Department for Transport on 2015/16 Major Scheme expenditure	£2,500 (estimated)	The assurance report was provided having delivered a programme of work prescribed by Department for Transport. This work does not impact on the accounting in the financial statements, does not provide any assurance as part of our financial statements audit and does not involve us providing any advice to, or taking any decisions for, the Council.
Total estimated fees	**£9,500**	
Total estimated fees as a percentage of the external audit fees	**9%**	

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