KPMG

cutting through complexity™

Report to those charged with governance (ISA 260) 2013/14

Police and Crime Commissioner for Humberside and Chief Constable of Humberside

September 2014

Contents

The contacts at KPMG in connection with this report are:

John Prentice
Partner/ Director
KPMG LLP (UK)

Tel: *0113 231 3935*
john.prentice@kpmg.co.uk

Rob Walker
Manager
KPMG LLP (UK)

Tel: 0113 231 3619
rob.walker@kpmg.co.uk

Kate Robinson
Assistant Manager
KPMG LLP (UK)

Tel: 0113 231 3994
katherine.robinson@kpmg.co.uk

This report is addressed to the Police and Crime Commissioner and the Chief Constable and has been prepared for their sole use. 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.audit-commission.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 John Prentice, 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 0303 4448 330.

Section one

Introduction

This document summarises:

- **the key issues identified during our audit of the financial statements for the year ended 31 March 2014 for the PCC and CC; and**
- **our assessment of the PCC's and the CC's arrangements to secure value for money (VFM) in its use of resources.**

Scope of this report

This report summarises the key findings arising from:

- our audit work at the Police and Crime Commissioner for Humberside ('the PCC') and the Chief Constable of Humberside ('the CC') on their 2013/14 financial statements; and
- our work to support our 2013/14 value for money (VFM) arrangements conclusion.

ISA 260 requires us to produce this report for those charged with governance; the PCC and the CC acting as corporations sole. We are also providing a copy of this report to the Joint Independent Audit Committee to assist with their role.

Financial statements

Our *External Audit Plan 2013/14*, presented to you in March 2014, set out the four stages of our financial statements audit process.

This report focuses on the second and third stages of the process: control evaluation and substantive procedures. Our on site work for this took place during April and July 2014.

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 arrangements conclusion

Our *External Audit Plan 2013/14* explained our risk-based approach to VFM work, which follows guidance provided by the Audit Commission.

We have now completed our work to support our 2013/14 VFM arrangements conclusion. This included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM arrangements conclusion;
- considering the results of any relevant work by the PCC and CC, 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 2013/14 financial statements of the PCC, CC and Group.
- Section 4 outlines our key findings from our work on the VFM arrangements conclusion.

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

Acknowledgements

We would like to take this opportunity to thank the finance team and other colleagues for their continuing help and co-operation throughout our audit work.

Headlines

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 unqualified audit opinions on the financial statements for both the PCC and CC by 30 September 2014. We will also report that the wording of your Annual Governance Statements accord with our understanding.
Audit adjustments	Our audit identified a total of two audit adjustments with a total value of £323k. One impacted on the PCC and one on the CC and PCC group. The impact of these adjustments is nil on each CIES and balance sheet. We have a further explanation of significant audit adjustments at Appendix 3. All of these were adjusted by the PCC and CC staff.
Changes in accounting approach	New authoritative guidance has been issued by CIPFA to assist police bodies in allocating financial activity between the PCC and the CC in their single entity financial statements. Costs have been split between the CC and the PCC to separately identify the resources consumed at the request of the Chief Constable from those costs exclusively incurred by the PCC. The CC has therefore recognised the costs of operational policing in their financial statements. Costs exclusively incurred by the PCC include day to day costs of administering the office of the PCC and supporting the PCC and Deputy PCC, as well as working directly with local communities and the public. A prior period adjustment has been made to ensure the financial statements are comparable between the two periods.

Headlines

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

Key financial statements audit risks	We review risks to the financial statements on an ongoing basis. We identified one significant risk specific to the PCC or the CC during 2013/14 with respect to the financial statements. This related to uncertainty as to the format of the financial statements due to the absence of appropriate guidance. We have worked with officers throughout the year to discuss this. The PCC and the CC addressed the issue appropriately.
Accounts production and audit process	Working papers were provided to support the financial statements in the same format as the prior year. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales. The PCC and the CC have implemented the recommendations in our *ISA 260 Report 2012/13* relating to the financial statements.
Completion	At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas: ■ *Review of the final Annual Governance Statements.* Before we can issue our opinion we require a signed management representations letter. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audits of the financial statements of the PCC and the CC.
VFM arrangements conclusion and risk areas	We have concluded that the PCC and the CC have made proper arrangements to secure economy, efficiency and effectiveness in their use of resources. We therefore anticipate issuing an unqualified VFM arrangements conclusion by 30 September 2014.

Proposed opinion and audit differences

Our audit identified a total of two audit adjustments.

The impact of these adjustments is nil.

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the financial statements of the PCC and the CC, following approval of the Statements of Accounts by the PCC and the CC, by 30 September 2014.

Audit differences

In accordance with ISA 260 we are required to report uncorrected audit differences to those charged with governance. 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 for this year's audit was set at £3.9 million for the PCC and the CC. Audit differences below £196k are not considered significant.

Our audit identified one significant audit difference, which we set out in Appendix 3. It is our understanding that this will be adjusted in the final versions of the financial statements.

The net impact on the Police Fund as a result of audit adjustments is no change to the balance as at 31 March 2014. This is mainly the result of the following amendments:

- Reduce Financing and Investment expenditure £280k in PCC
- Reduce Financing and Investment income £280k in PCC

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

- Credit note 12 (Note 7 CC) exit packages banding £20 – 40k by £43k in CC and PCC Group
- Debit note 12 (note 7 CC) exit packages banding £40 – 60k £43k in CC and PCC Group

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 2013/14 ('the Code')*. We understand that the PCC and PC will be addressing these where significant.

Annual Governance Statements

We have reviewed the Annual Governance Statements and confirmed that:

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

We have made a number of comments in respect of format and content which the PCC and the CC have agreed to amend where significant.

Changes in accounting approach

We have worked with management to consider the implications of the new accounting guidance issued by CIPFA. The PCC and the CC have revised the accounting approach adopted for 2013/14, and in the prior period, to reflect these discussions.

For 2013/14, the PCC and the CC have changed the basis on which their single entity financial statements have been produced.

Prior period approach

For 2012/13, in common with PCCs and CCs in many other police areas, the PCC and the CC adopted the concept of agent/principal when accounting for their activity. This approach recognised:

- the PCC's strategic policing role in setting the Police and Crime Plan;
- the CC's use of assets owned by the PCC, and of police staff employed by the CC, to deliver the CC's operational policing role; and
- the PCC's ability to hold the CC to account.

As a result, it was considered that the CC was acting as the PCC's agent, with the CC managing the PCC's resources to meet the PCC's strategic objectives, rather than as a principal in their own right. This meant that operational policing and all other activity was recognised in the PCC's primary statements only, with the CC producing 'zero' accounts, that explained their role and showed the resources deployed by the CC on the PCC's behalf, but did not recognise any income and expenditure or assets and liabilities.

Despite the significantly different approaches adopted by different police bodies, there were no qualified audit opinions issued in 2012/13 because the lack of definitive guidance meant that the wide range of different approaches were all considered reasonable to reflect the nature of local arrangements.

Why change the approach for 2013/14?

The inconsistencies that were apparent in 2012/13 prompted a reconsideration of the basis of police accounting and a desire for greater consistency between the accounts of PCCs and CCs in different police areas.

Changes enacted in the Anti-Social Behaviour Act 2014 made CCs local authorities in their own right, changed the statutory basis on which CCs prepared their financial statements, legally requiring them to adopt the Code of Audit Practice for Local Accounting, and permitting CIPFA to consider issuing guidance on interpreting the Code for CCs.

In March 2014, CIPFA issued LAAP Bulletin 98A which provided police bodies with authoritative guidance on apportioning activity and assets between the PCC and the CC in their respective single entity financial statements. The Audit Commission and its audit suppliers, including KPMG, have discussed the guidance to ensure a consistent approach is being adopted to the audit of PCC and CC accounts in 2013/14.

What changes have been made?

Following discussions between the Head of Accountancy and us, we have agreed that, on the basis of the new guidance issued since our 2012/13 audit opinion was issued in September 2013, it is appropriate to change the accounting approach adopted for 2013/14.

In 2013/14, the CC is recognising the operational costs of policing as costs within the Comprehensive Income and Expenditure Statement. This includes the full costs of employing police officers and civilian staff (including the related share of pension interest cost and actuarial movements), except for staff employed in the Office of the PCC.

All other income and expenditure, assets and liabilities are recognised by the PCC in their single entity financial statements. A prior period adjustment has been made to both sets of financial statements to apply the same accounting approach to the prior period, to make the financial performance and position in both years comparable.

There have been no changes to the group financial performance or position reported in 2012/13 as a result of these changes.

Key financial statements audit risks

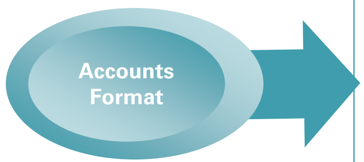
We have worked with officers throughout the year to discuss specific risk areas. The PCC and the CC have addressed the issues appropriately.

In our External Audit Plan 2013/14, presented to you in March we identified the key risks affecting the 2013/14 financial statements for the PCC and CC. 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 of the risks that are specific to the PCC and the CC.

Additionally, we considered the risk of management override of controls, which is a standard risk for all organisations.

Our 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, did not identify any issues

Key audit risk	Issue	Findings
	Risk The key challenge faced by the PCC and CC in the accounts production 2012/13 was the format of the accounts as the Code guidance has not been sufficiently detailed to provide a full framework on which to base the two sets of financial statements and the group financial statements. Detailed guidance for 2013/14 was received in early 2014 and we reviewed your proposed approach at draft accounts stage.	We were satisfied that your accounts complied with the revised guidance. In a comparison of your draft statements with others your notes explaining the rationale behind the allocation of costs and assets between the PCC and CC was seen as an exemplar.

Accounts production and audit process

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

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

The PCC and the CC have implemented all of the recommendations in our ISA 260 Report 2012/13.

Accounts production and audit process

ISA 260 requires us to communicate to those charged with governance, the PCC and the CC as corporations sole, our views about the significant qualitative aspects of their accounting practices and financial reporting. We also assessed the processes for preparing the accounts and supporting efficient audits.

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 30 June 2014. The PCC and the CC made a number of amendments of a presentational nature after this date following our review of the financial statements and substantive audit work.
Quality of supporting working papers	Our *Accounts Audit Protocol*, which we issued in February and discussed with the Head of Accountancy, set out our working paper requirements for the audit. The quality of working papers provided met the standards specified in our *Accounts Audit Protocol*.
Response to audit queries	Officers resolved audit queries in a reasonable time.

Prior year recommendations

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

The PCC and the CC have implemented the recommendation in our *ISA 260 Report 2012/13.* This recommendation focused on the format of the financial statements.

Completion

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

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

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

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 the Police and Crime Commissioner for Humberside and the Chief Constable of Humberside for the year ending 31 March 2014, we confirm that there were no relationships between KPMG LLP and the Police and Crime Commissioner for Humberside and the Chief Constable of Humberside, their senior officers and management and their 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 templates to the Head of Accountancy for presentation to the PCC and the CC. We require a signed copy of these management representations before we issue our audit opinions.

Other matters

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

- significant difficulties encountered during the audit;
- significant matters arising from the audit that were discussed, or subject to correspondence with management;
- other matters, if arising from the audit that, in the auditor's professional judgement, are significant to the oversight of the financial reporting process; and
- matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. significant deficiencies in internal control; issues relating to fraud, compliance with laws and regulations, subsequent events, non disclosure, related party transactions, 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 2013/14 financial statements for the PCC and the CC.

VFM arrangements conclusion

Our VFM arrangements conclusion considers how the PCC and the CC secure financial resilience and challenges how they secure economy, efficiency and effectiveness.

We have concluded that the PCC and the CC have both made proper arrangements to secure economy, efficiency and effectiveness in their use of resources.

Background

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

- securing financial resilience: looking at the financial governance, financial planning and financial control processes at both the PCC and the CC; and
- challenging how the PCC and the CC secure economy, efficiency and effectiveness: looking at how they prioritise resources and improve 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 PCC and the CC to mitigate these risks and plan our work accordingly.

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

Work completed

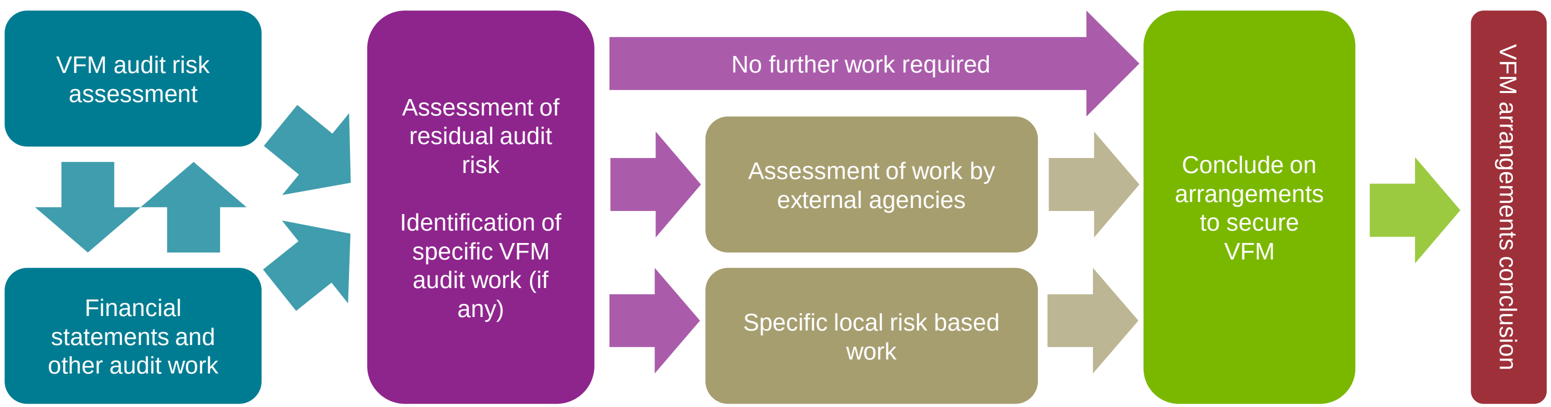
We performed a risk assessment earlier in the year and have reviewed this throughout the year.

We have not identified any significant risks to our VFM arrangements conclusion and therefore have not completed any additional work.

Conclusion

We have concluded that the PCC and CC have made proper arrangements to secure economy, efficiency and effectiveness in their use of resources.

VFM criterion	Met	
	PCC	CC
Securing financial resilience	✓	✓
Securing economy, efficiency and effectiveness	✓	✓



Appendix 1: Key issues and recommendations

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

The PCC and the CC should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up this recommendation 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	Relevant body	Issue and recommendation	Management response / responsible officer / due date
1	❸	**Both PCC and CC**	**IT policies and strategy** These documents have been rolled forward from the Humberside Police Authority. **Recommendation** Update these documents to reflect the PCC Group environment and risks.	

Appendix 3: Audit differences

This appendix sets out the significant audit differences.

We are reporting all audit differences over £196k.

It is our understanding that all of these have been 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, i.e. the PCC and the CC as the corporations sole. 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.

Corrected audit differences

Our audit identified one significant audit difference. It is our understanding that this will be adjusted in the final versions of the financial statements.

The net impact on the Police Fund as a result of audit adjustments is no change to the balance as at 31 March 2014. This is mainly the result of the following amendments:

- Reduce Financing and Investment expenditure £280k in PCC
- Reduce Financing and Investment income £280k in PCC.

This adjustment related to the write back of a provision for Icelandic bank debt. In the PCC Group financial statements this had been treated appropriately as a reduction to cost, however in the PCC financial statements it had been treated as income. The adjustment brings the single entity treatment into line with the Group reflecting the write back of provision as a reduction to cost.

Appendix 4: Declaration of independence and objectivity

The *Code of Audit Practice* requires us to exercise our professional judgement and act independently of the Commission, the PCC for Humberside and the CC of Humberside.

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 this. These matters should be discussed with the Joint Independent 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.

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 audits of the PCC for Humberside and the CC of Humberside.

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 for the financial year ending 31 March 2014 for the PCC for Humberside and the CC of Humberside, we confirm that there were no relationships between KPMG LLP and the PCC for Humberside and the CC of Humberside, their senior officers and management and their 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.

KPMG

cutting through complexity™