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Herefordshire Council

**Annual Internal Audit Report
2012/13**

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	To (for information):
	David Powell – Chief Officer Finance and Commercial
	Audit and Governance Committee

1. Introduction

This report sets out Internal Audit's opinion on Herefordshire Council's risk management, internal control and governance processes.

Introduction

The purpose of this report is to provide Herefordshire Council (the Council) with an overall internal audit opinion and commentary on internal audit activity and matters arising from the completion of the 2012/13 Annual Internal Audit Plan.

Internal audit within the public sector is governed by the *Public Sector Internal Audit Standards* (PSIAS), on which CIPFA has published a *Local Government Application Note* which provides guidance on the application of the PSIAS to local authorities.

Within the standards, the Chief Audit Executive (referred to as the Head of Internal Audit within the Council) must deliver an annual internal audit opinion and report that can be used by the Council to inform its governance statement.

The annual internal audit opinion must conclude on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control.

The annual report must incorporate:

- the opinion (*Section Two*);
- a summary of the work that supports the opinion (*Section Four*); and
- a statement on conformance with the PSIAS and the results of the quality assurance and improvement programme (*Section Five*).

Additionally and in accordance with *Local Government Application Note* the Annual Report must also detail the following:

- the disclosure of any qualifications to that opinion, together with the reasons for the qualification (*Section Two*);
- the disclosure of any impairments (*'in fact or appearance'*) or restriction in scope (*Section Two*);
- a comparison of the work actually undertaken with the work that was planned (*Section Four and Appendix 1*);
- a summary of the performance of the internal audit function against its performance measures and targets (*Section Five*);
- any issues the Chief Audit Executive judges particularly relevant to the preparation of the annual governance statement (*Section Two*); and
- progress against any improvement plans resulting from an external assessment (*Section Five*).

1. Introduction (*cont.*)

The roles and responsibilities of Internal Audit and Management.

Role of Management and Internal Audit

Under the Accounts & Audit Regulations 2011, the Council has a duty to ensure that its financial management is adequate and effective, that there is a sound system of internal control and robust risk management arrangements are in place.

The primary responsibility for maintaining effective risk, control and governance arrangements rests with management. It is management's responsibility to establish and maintain the systems of internal control so that activities are conducted in an efficient and well-ordered manner. This management responsibility is devolved under Section 151 of the Local Government Act 1972 to the Council's Chief Financial Officer. At the Council this responsibility rests with the Chief Officer – Finance & Commercial Services.

Internal Audit is the independent appraisal function established by management to review the internal control system as a service to the Council. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources.

Internal Audit also acts as an aid to management and produces reports as a result of each of the reviews undertaken. It works in partnership with management to find solutions to any issues identified and seeks its agreement to any recommendations for improvement.

2. Opinion

This section sets out our opinion and how we have arrived at this based on the work undertaken.

Formulation of opinion

Our internal audit work was carried out in accordance with the Internal Audit Plan approved by the Audit & Governance Committee on 6 July 2012. The Plan was constructed in such a way as to allow us to make a statement on the adequacy and effectiveness of the Council's governance, risk management and control processes. Our report provides one element of the evidence that underpins the Annual Governance Statement (AGS) the Council is required to make within its annual financial statements. This is only one aspect of the assurances available to the Council as to the adequacy of its governance, risk management and control processes. Other sources of assurance on which the Council may rely on could include:

- the work of the External Auditors;
- the result of any quality accreditation;
- the outcome of any visits by government agencies;
- other pieces of consultancy or third party work designed to alert the Council to areas of improvement; and
- other external review agencies (i.e. OFSTED).

As the providers of internal audit to the Council, we are required to provide the Section 151 Officer (the Chief Officer – Finance & Commercial Services) with an opinion on the adequacy and effectiveness of the Council's governance, risk management and control processes. In giving our opinion it should be noted that assurance can never be absolute. The most that internal audit can provide to the Section 151 Officer is reasonable assurance that there are no major weaknesses in the Council's governance, risk management and control processes. In assessing the level of assurance to be given, we have taken into account:

- all audits undertaken during the year;
- any significant recommendations not accepted by management and the consequent risks;
- the effects of any significant changes in the Council's objectives or systems;
- matters arising from previous reports to the Audit & Governance Committee; and
- any limitations which may have been placed on the scope of the internal audit.

We can confirm that there have not been any impairments (in fact or appearance) or restriction in the scope of our work. Additionally, there are not any qualifications to our opinion.

We are satisfied that sufficient internal audit work has been undertaken to allow us to draw a reasonable conclusion as to the adequacy and effectiveness of the Council's risk management, control and governance processes.

Opinion

In our opinion, the Council has adequate and effective risk management, control and governance processes to manage the achievement of its objectives, except for those areas highlighted as limited in Appendix 1. In these areas agreed improvement plans are in place.

3. Summary of our work and Significant Control Issues

We concluded that the majority of the Council's systems reviewed were rated as **Substantial or Adequate**. However, a number of areas were also graded as **Limited**.

Summary of our Work

We have completed the majority of our reviews and special assignments either in draft or in final. In many areas the Council's arrangements are adequate. We have also issued four Limited Assurance opinions during the year which means that the Council needs to improve control environments in these areas. These were its Data Protection, Legal Services, Industrial Lets (income collection) and Food Licensing functions. It is important that the identified improvements are addressed on a timely basis to manage risks.

Overall view

The Council faced and continues to face a number of challenges that have come together at a single moment in time. These include addressing key issues such as the financial management arrangements in Adult Social Care, managing activities within a significantly reduced funding envelope as a result of government cuts, determining the future of the Highways contract, developing and improving working arrangements with Hoople and driving through efficiency savings in the way in which all services are delivered. This is a significant change agenda on top of delivering business as usual.

At such a time the Council needs to ensure that its governance, risk management and control processes continue to be effective.

Through our work we have seen examples of where the Council, once informed of key weaknesses within these areas, has improved processes to ensure that they are effective. For example, the Council implemented action plans to correct significant control issues which we identified in 2011/12 in some of the Council's key financial and IT functions. These actions were effective and risk management, control and governance in these areas has improved. The key issue for the Council is to ensure that these functions remain well controlled through the significant change processes that it is seeking to implement in 2013/14.

However, in some key areas the effective implementation of key controls is inconsistent. These functions are more on the operational side, such as Data Protection and Legal Services. Therefore, the Council will need to ensure that there is strong central control and oversight of operational areas in 2013/14 so that they continue to meet their objectives and key risks are being managed appropriately.

Significant Control Issues

The Council is required to include in its Annual Governance Statement (AGS) any significant control issues. While we note that the Council has improved controls over its key financial and IT systems in 2012/13, based on the reviews undertaken we believe the following issues should be included:

- the controls over Data Protection need strengthening to ensure that the risks in relation to inappropriate access and manipulation of data are mitigated;
- the Council needs to develop controls within its Legal Services, Industrial Lets and Food Licensing functions to ensure that they can meet their objectives and manage key risks; and
- the controls within the Adult Social Care function require strengthening to ensure that the system can meet its objectives in terms of the service it delivers and the financial resources being managed.

It should be noted that there is already evidence that controls over the Data Protection function system have been strengthened. Action is also being taken by the Council in respect of the other areas.

4. Detailed Findings

This section sets out our progress in completing the reviews set out on the Internal Audit Plan.

Progress against the Internal Audit Plan

The Internal Audit plan was approved by the Audit & Governance Committee on 6 July 2012.

The following section provides further comment on the status of the reviews within the agreed plan:

- 21 audit reviews have been either completed or are in draft. Appendix 1 sets out the audit opinions we have given to each area audited where these have been finalised at the time of drafting this report. An overall summary of the gradings and the priority of the recommendations made over the year are set out within the graphs on pages seven and eight. We also have provided further information in Appendix 2 of how we grade our audit reports and our audit recommendations.
- Eight reviews are in progress and are currently being completed. In four areas we are following up recommendations where Limited assurance opinions were previously given; these were Health & Safety, Performance Management, Business Continuity and Sustainability. In discussions with management we were informed that they believe good progress has been made in ensuring that controls have been improved in these areas since our original reports were issued in 2012. Our independent assessment of the progress in improving controls in these key areas will be reported to the Audit & Governance Committee.
- Two audits were deferred. Our work in relation to the Council's IT Strategy will now be completed in 2013/14 as the Council is currently reviewing its overall IT requirements. Our work in relation to the schools function was also deferred. This will allow us to review and test how Schools are complying with the new Financial Value Standard which fully came into effect in 2012.
- Our work in relation to Adult Social Care has been incorporated within a KPMG consultancy review which is currently being completed. Additionally, our Anti-Fraud and Corruption work has been completed within the Audit Commission survey return in this area.
- Our work in relation to Procurement within the Places & Communities function was superseded as the function has required additional consultancy support in another area which is currently being provided.

Audit Services has also contributed into a number of other reviews for the Council. We have provided further details on this on Page 9.

4. Detailed Findings (cont.)

This section sets out the audit opinions given to each audit area, together with the number and priority of recommendations which we have made.

Findings from our work

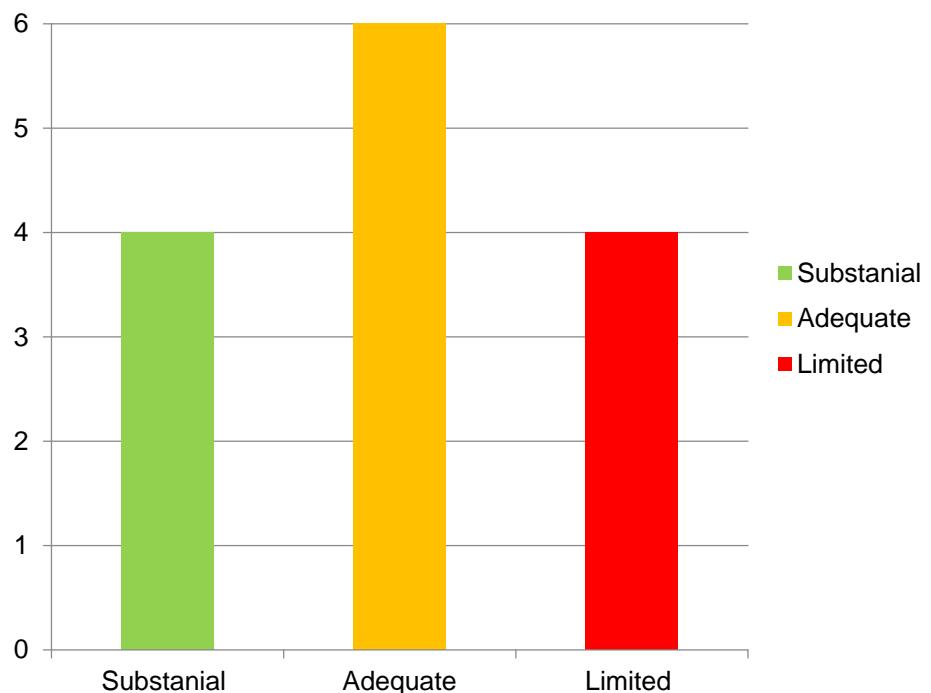
The graphs below show the overall assurance grades we have given for the reports issued and the number and priority of recommendations made in the period.

We have issued a total of 14 final audit reports and made 53 recommendations. Four areas were graded as **Substantial Assurance** which reflects positively on the organisation and its control framework. These include areas such as Treasury Management, NNDR and Council Tax and Housing Benefit. Six areas have been rated as **Adequate Assurance** and this assurance conclusion suggests scope to improve, but not fundamental control weaknesses. These areas included General Ledger, Access Controls to the Academy and IDOX systems, Income collection (Car Parking) and ISO 27001 Modern Records Unit.

Four areas were rated as **Limited Assurance** indicating that the control framework is weak within that area and significant improvements are required to ensure that key risks are being mitigated. These were Data Protection, Legal Services, Industrial Lets (income protection) and Food Licensing.

The Council has recognised that significant improvements are required to these systems and has put in place action plans to resolve the issues which Internal Audit has highlighted.

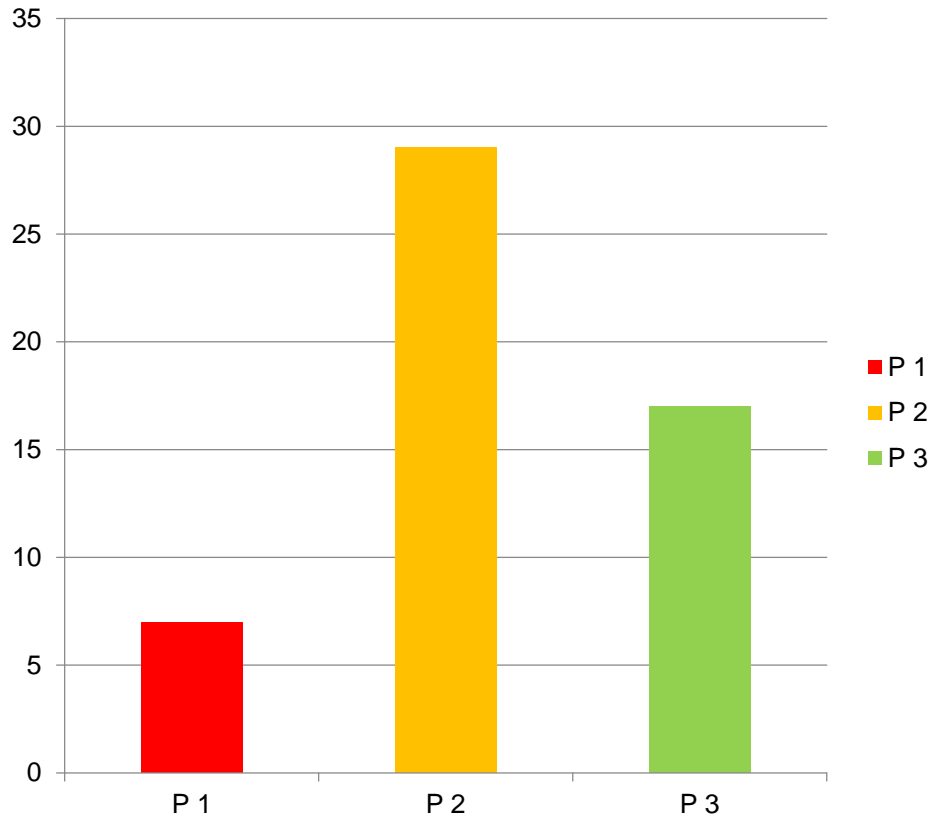
Graph setting out a summary of Audit Opinions during the year



4. Detailed Findings (cont.)

This section sets out the number and priority of recommendations which we made.

Graph setting out the number and priority of audit recommendations made during the year



We raised seven priority one recommendations, 29 priority two and 17 priority three recommendations in 2012/13.

4. Detailed Findings (*cont.*)

This section details further work which we completed in addition to the reviews set out within the Annual Internal Audit Plan.

Other work completed - Assistance and Guidance

Internal Audit has provided assistance and guidance to Chief Officers, Directors and Members in the following areas:

- Capitalisation of highways expenditure - This review was requested by the Chief Officer, Finance & Commercial Services. This review assessed how the Council accounts for this type of expenditure and ensures compliance with the CIPFA Code of Practice on Local Authority Accounting.
- Capital programming – At the request of the Chief Officer, Finance & Commercial Services, we reviewed the Council's capital planning process which identifies and agrees capital expenditure schemes.
- Integrated Community Equipment Store (ICES) - Audit Services was requested by the Chief Officer, Finance and Commercial Services to review and assess internal controls within the ICES. This function is funded through Section 75 of the National Health Service Act 2006 and provides equipment to aid independent living.
- Adult Social Care function - The Council has worked together with KPMG in reviewing key aspects of this function. This work has involved reviewing aspects of the function's IT systems, such as the link between the Frameworki system and the Council's Agresso financial system, in addition to how it procures Care Services.
- Audit Services has also completed work in other areas as requested by the Chief Officer, Finance and Commercial Services and other officers within the Council. For example, we have reviewed the process by which the Council is seeking to make payments to its partners as part of the Borders Broadband project. In addition, we are reviewing the processes and controls which the Council have put in place to manage the delivery of the Social Fund. The Council has recently taken on the responsibility for the management of the fund within the County from the Department of Work and Pensions.
- Audit Services along with KPMG is also completing work in other areas, such as the Direct Payments process within Adult and Social Care, reviewing the use of mobile phones within the Council and assisting in the external validation of ISO 27001 which the Council has in place.

4. Detailed Findings (cont.)

This section sets out the results of our follow up work on recommendations made in 2012/13.

Follow up of prior year recommendations

As part of our work we followed up on our work completed in 2011/12.

This was through reviewing areas that were graded as providing the lowest level of assurance in the previous year. This was to assess the progress the Council had made in improving the control environment within that function. As part of this work we are in the process of reviewing the Health and Safety, Business Continuity, Performance Management and Sustainability functions. In discussions with management we were informed that they believe good progress has been made in ensuring that controls have been improved in these areas since the original report was issued. Our independent assessment of the progress in improving controls in these key areas will be reported to the Audit & Governance Committee.

A second element of our work involved reviewing priority one recommendations made within audit reports issued in 2011/12 to assess if they had been effectively implemented. This was through Internal Audit reviewing the same function as part of the Internal Audit Plan 2012/13. The table below details the findings from this assessment

Area	Priority 1 rec's made	Implemented	Partly Implemented	Not implemented
General Ledger	2	-	2	-
Agresso - Access Controls	6	2	3	1
Creditors	3	1	1	1

We noted that the Council has made some progress in implementing prior year priority one recommendations.

However, we reiterate the importance of ensuring that priority one recommendations are implemented on a timely basis.

5. The Internal Audit function

This section sets out how we have performed against our Key Performance Indicators and with reference to the Public Sector Internal Audit Standards.

We have also set out feedback which we have received from Directors and Managers.

Performance of Internal Audit

There are a number of ways Internal Audit measures its performance. These include assessing performance against a set of Key Performance Indicators (KPIs), reviewing compliance with the Public Sector Internal Audit Standards (PSIAS) and feedback from management through regular meetings and surveys.

Key Performance Indicators

This section sets out how the Internal Audit function has performed against its Key Performance Indicators (KPIs).

Performance Measure	Target	Actual	Comment
TOR issued and agreed at least 5 days before start of audit	95%	100%	-
Draft report issued 10 days or less after debrief	95%	69%	See Note 1 below
Management responses received within 10 working days of draft issued	95%	38%	See Note 2 below
Final report issued within 5 days after management responses	95%	100%	-
Number of recommendations agreed by management	95%	100%	-
Client Satisfaction Rate (based on number of survey responses received)	90%	100%	See Note 3 below

Note 1

We were unable to meet this target in four instances. In each case this was due to further information received from management after the de-brief date. This necessitated further on-site work to be completed which delayed the issuing of the draft report.

Note 2

This indicator relates to management replying to draft reports on a timely basis. In a number of instances management did not forward their responses to our draft reports within the required timescales. In not doing so, we were unable to ensure findings were submitted to the Audit & Governance Committee on a timely basis. Additionally, we were unable to ensure if management acknowledged the control weaknesses that had been identified within our reports and that they had implemented processes to prevent key risks materialising. We have been in discussions with senior management at the Council on how the process of finalising draft reports can be improved and we are aiming to see an improvement in this indicator over the forthcoming year.

Note 3

Historically, there has been a very low level of response to the Audit Feedback surveys issued to Managers. This has again been the case for 2012/13. However, in the limited number of surveys returned the feedback has been very positive. Additionally, through informal e-mail feedback, management have stated that they have valued the input Internal Audit has provided in improving their processes and controls. In 2013/14 we will re-assess again how we can gain more feedback from Managers and report the results to future Committee meetings.

5. The Internal Audit function (cont.)

This section sets out our level of compliance with the Public Sector Internal Audit Standards (PSIAS).

PSIAS Compliance

The PSIAS alongside the CIPFA Local Government Application Note sets out how the Internal Audit service should be provided within a local authority. These standards come into force in April 2013.

On an annual basis compliance against the standards should be assessed and reported to management and Members. As part of our report we have assessed the function and the work performed in 2012/13 against these standards. We acknowledge that full compliance with the standards may not be possible as they were only recently issued, however we have used this assessment as an opportunity to understand how the function can develop and to work towards full compliance in 2013/14.

The following table sets out the key standards within the code, if the Internal Audit function is complying with the standard, fully or partially and any comments flowing from the assessment.

Standard	Compliance achieved (Full/ Partial /None)	Comments
Definition of Internal Auditing	Full	-
Code of Ethics	Full	-
Attribute Standards	Partial New Requirement	<p><i>Attribute Standard 1230 - Continuing Professional Development</i></p> <ul style="list-style-type: none"> Staff competences - Job descriptions detailing skills and competencies for the Internal Audit Team require updating following their transfer to Hoople. Once completed this will allow the Head of Internal Audit to assess individual auditors against these criteria. This will be completed by Hoople in July 2013. <p><i>Attribute Standard 1300 - Quality Assurance and Improvement Programme (QAIP)</i></p> <ul style="list-style-type: none"> The Standards require a QAIP to be developed, monitored and reported both to management and the Audit & Governance Committee. This is a new Standard and wasn't a requirement of previous internal audit standards. The Programme is designed to assess conformance with the Standards and also to assess the efficiency and effectiveness of the internal audit function and identify areas for improvement. We will be developing a QAIP in 2013 and report to management and Members how the efficiency and effectiveness of the function maybe further developed and our conformance with the Standards <p><i>cont overleaf.</i></p>

5. The Internal Audit function (cont.)

This section sets out our level of compliance with the Public Sector Internal Audit Standards (PSIAS).

Standard	Compliance achieved (Full/ Partial /None)	Comments
Attribute Standards	New Requirement	<ul style="list-style-type: none"> • <i>Attribute Standards 1312 – External Assessments</i> <p>This is a new Standard and was not a requirement of previous internal audit standards.</p> <p>This Standard requires an external body or person to complete an assessment of the internal audit function against the PSIAS once every five years. It also states that the format of the external assessment must be discussed and agreed prior to its commencement with Members.</p> <p>Currently, the procedures which underpin this requirement are not yet sufficiently developed to make it clear what is required in the context of an outsourced Internal Audit arrangement, such as the one in place at the Council. Additionally, the requirement states that this external assessment should occur once every five years.</p> <p>Given these two issues we will over the forthcoming year assess the applicability of this standard to the Internal Audit function at the Council. We will discuss and agree our findings with the Audit & Governance Committee.</p>
Performance Standards	Full	-

We confirmed that in the majority of areas, the Internal Audit Service is complying with the requirements of the new PSIAS. Where there are new requirements we are putting in processes to ensure full compliance or assessing the significance and impact of the issue and its relevance to the Council.

5. The Internal Audit function (cont.)

This section sets out how our work was delivered with reference to the number of audit days agreed within the Annual Internal Audit Plan.

Audit Resource

In 2012/13 audit days were delivered through a combination of Council staff and input from KPMG. For the first 3 months of the year Council staff completed work on the previous year and other ad-hoc work. In the Annual Internal Audit Plan 2012/13 which we presented to the Audit & Governance Committee on 6 July 2012 we envisaged inputting a total of 850 days in order to complete the Internal Audit Plan.

We are currently completing the plan and it will be delivered within the number of days originally reported. However, a total of 145 days will be moved from 2012/13 into the 2013/14 Internal Audit year to complete the remainder of the audit work for this year. This was agreed as part of the 2013/14 Annual Internal Audit Plan.

Appendix 1 – Work completed

This appendix sets out the work which we completed during the year, the audit opinions given to each audit area, together with the number and priority of recommendations which we made.

Review	Grading	Recommendations			Status
		P1	P2	P3	
Payroll					Draft report issued
Creditors					Draft report issued
Treasury Management	Substantial	-	-	-	Completed
Income Collection – Car Parking	Adequate	-	1	1	Completed
Income Collection – Bereavement Services	Adequate	-	2	1	Completed
Income Collection – Industrial Lets	Limited	1	2	-	Completed
Debtors	Substantial	-	-	4	Completed
Budgetary Control					In progress
NNDR and Council Tax	Substantial			2	Completed
General Ledger	Adequate	-	1	4	Completed
Benefits (Council Tax and Housing)	Substantial	-	-	-	Completed
Asset Register					In progress
Procurement					In progress
Rising to the Challenge – Project Review					Completed - Audit Services has input into the Council's Rising to the Challenge Closure Report rather than complete an audit of this area.
Health and Safety – Follow Up					In progress
Sustainability – Follow Up					In progress
Business Continuity – Follow Up					In progress

Appendix 1 – Work completed (cont.)

This appendix sets out the work which we completed during the year, the audit opinions given to each audit area, together with the number and priority of recommendations which we made.

Review	Grading	Recommendations			Status
		P1	P2	P3	
Legal Services	Limited	2	7	-	Completed
ISO 27001 Modern Records Unit	Adequate		4	-	Completed
ISO 27001 ICT Services	Adequate	-	4	-	Completed
Access Controls – Academy and IDOX	Adequate	-	2	1	Completed
Access Controls review - Agresso – Follow Up					Draft Report issued
Data Protection	Limited	3	2	-	Completed
IT Strategy					In discussions with management we have agreed to defer this audit to 2013/14 as the Council is currently reviewing its overall IT requirements.
Anti-Fraud and Corruption Arrangements					This work will involve joint KPMG and Council workshops which are currently being arranged.
Anti-Fraud and Corruption – Procedures Audit					These audits have been incorporated within the work required to complete the Audit Commission's Anti-Fraud and Corruption survey.
Anti-Fraud and Corruption – Hot Topics and Risk Areas					
Audit Commission - Anti-Fraud Survey					Completed.

Appendix 1 – Work completed (cont.)

This appendix sets out the work which we completed during the year, the audit opinions given to each audit area, together with the number and priority of recommendations which we made.

Review	Grading	Recommendations			Status
		P1	P2	P3	
Performance Management – Follow Up					In progress
Hoople – Client Side Management					Completed - We have reviewed (where appropriate) the Council's contract management arrangements with Hoople as part of the audits we have completed.
Hoople – Governance/ Performance Management					Draft report issued
Adult and Social Care – Financial Management and Follow Up					The reviews of these areas have been incorporated within a KPMG consultancy review which is currently being completed.
Adult and Social Care – Procurement (Follow Up)					
Places and Communities - Public Health – Food Licensing	Limited	1	4	4	Completed
Places and Communities – Procurement					The need for this audit has been superseded by the Council needing additional consultancy support in this area which is currently being provided.
Financial Management - Schools					Audit deferred until 2013/14. This will allow us to review and test how Schools are complying with the new Financial Value Standard which fully came into effect in 2012.

Appendix 2 - Audit Grades and Opinions

We rate overall reports and individual recommendations based on a set grading system.



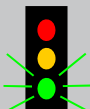
Report Grading

The table below summarises the definitions we apply to the report grading system we use.

Grade	Explanation
Substantial	No or priority three only recommendations. (i.e. any weaknesses identified relate only to issues of good practice which could improve the efficiency and effectiveness of the system or process).
Adequate	One or more priority two recommendations (i.e. there are weaknesses requiring improvement but these are not vital to the achievement of strategic aims and objectives - however, if not addressed the weaknesses could increase the likelihood of strategic risks occurring).
Limited	One or more priority one recommendations, or a high number of medium priority recommendations that taken cumulatively suggest a weak control environment (i.e. the weakness or weaknesses identified have a significant impact preventing achievement of strategic aims and/or objectives; or result in an significant exposure to reputation or other strategic risks).
No	One or more priority one recommendations and fundamental design or operational weaknesses in more than one part of the area under review (i.e. the weakness or weaknesses identified have a fundamental and immediate impact preventing achievement of strategic aims and/or objectives; or result in an unacceptable exposure to reputation or other strategic risks).

Recommendation Grading

Following each review, we raise performance improvement observations. The priority of these can be defined as follows:

Priority	Explanation
	Priority One - A significant weakness in the system or process which is putting the organisation at serious risk of not achieving its strategic aims and objectives. In particular: significant adverse impact on reputation; non-compliance with key statutory requirements; or substantially raising the likelihood that any of the organisation's strategic risks will occur. Any recommendations in this category would require immediate attention.
	Priority Two - A potentially significant or medium level weakness in the system or process which could put the organisation at risk of not achieving its strategic aims and objectives. In particular, having the potential for adverse impact on the organisation's reputation or for raising the likelihood of the organisation's strategic risks occurring.
	Priority Three - Recommendations which could improve the efficiency and/or effectiveness of the system or process but which are not vital to achieving the organisation's strategic aims and objectives. These are generally issues of good practice that we consider would achieve better outcomes.



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