KPMG

cutting through complexity™

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

Leeds City Council

September 2014

Contents

The contacts at KPMG in connection with this report are:

John Prentice
Director
KPMG LLP (UK)
Tel: 0113 231 3935
Mob: 07827 939020
john.prentice@kpmg.co.uk

Alison Ormston
Senior Manager
KPMG LLP (UK)
Tel: 0113 231 3444
alison.ormston@kpmg.co.uk

Chris Hall
Assistant Manager
KPMG LLP (UK)
Tel: 0113 231 3493
Mob: 07921 450502
chris.hall2@kpmg.co.uk

Introduction

This document summarises:

- **the key issues identified during our audit of the Authority's financial statements for the year ended 31 March 2014; and**
- **our assessment of the Authority's arrangements to secure value for money.**

Scope of this report

This report summarises the key findings arising from:

- our audit work at Leeds City Council ('the Authority') in relation to the Authority's 2013/14 financial statements; and
- the work to support our 2013/14 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

Financial statements

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

We previously reported on our work on the first two stages in our *Interim Audit Report 2013/14* issued in June 2014.

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

Our *External Audit Plan 2013/14* explained our risk-based approach to VFM work. We have now completed the work to support our 2013/14 VFM conclusion. This included:

- reviewing the performance against the 2013/14 budget;
- assessing the Authority's financial resilience in the short and medium term; and
- carrying out additional risk-based work, where necessary.

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 Authority.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1. We have also completed our review of whether all prior-year recommendations have been implemented and this is commented upon on page 7.

Acknowledgements

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

Headlines

This table summarises the headline messages. 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 Authority's financial statements by 30 September 2014. We will also report that the wording of your Annual Governance Statement accords with our understanding.
Audit adjustments	We are pleased to report there are no unadjusted audit misstatements.
Key financial statements audit risks	We highlighted audit focus areas around provisions and contingent liabilities and the Authority's financial standing in our External Audit Plan. However, following work carried out throughout the audit process we concluded that none of these areas resulted in a significant risk to our opinion on the accounts or VFM. Following our review of the draft financial statements, we identified three significant risks: ■ The valuation of property, plant and equipment (PPE); ■ The valuation of the local government pension fund liability; and ■ The completeness of disclosures in relation to PFI schemes. Significant risks are areas of the accounts that require special audit consideration. The Balance Sheet valuations of PPE (£3.3bn) and the pension liability (£918m) both involve the use of an expert by management; the in-house property valuer and pension scheme actuaries apply judgement in arriving at their valuation. Review of the draft financial statements showed significant movements from 2012/13. We assessed the reliability of the experts and the accuracy of the disclosures in the financial statements and concluded that the balances were reasonable. There were two new PFI liabilities in 2013/14 – Holt Park and Little London, Holbeck and Beeston – which were disclosed in the financial statements. Whilst we did not consider the recognition of these new schemes to present a significant risk due to the values involved, we did consider compliance with the disclosure requirements to be a risk. The Code of Practice on Local Authority Accounting in the UK 2013/14 ("the Code") requires various disclosures in relation to PFI schemes, including the estimated future revenue and capital costs, which are material. We found that the service cost element of all PFI contracts were not disclosed in the draft financial statements, but have now been included in the final version..

Headlines

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

Accounts production and audit process	The draft financial statements were produced by the 30 June deadline and officers dealt with audit queries in a timely manner. In general, we noticed an improvement in the timeliness of working papers, although there were still some occasions where we had to delay carrying out the work on a particular area because working papers were not ready, for example cash flow, HRA and Whole of Government Accounts (“WGA”). As officers reported to Governance and Audit Committee in July, several changes were made from the original draft financial statements to the version that went on deposit, mainly to incorporate PPE valuations that were received late in the process. The Authority did not achieve the deadline for submission of the WGA return to the Department for Communities and Local Government (DCLG) and auditors by 30 June. This was submitted on 15 August. The Authority made the decision to delay completing the return due to other competing pressures such as completing the draft 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: ■ Checking of the group accounts and related disclosures; ■ Review of the letter of assurance from the West Yorkshire Pension Fund auditors Mazars; ■ Carrying out the final checks on the financial statements; and ■ Review of possible post-balance sheet events, in particular around potential contingent liabilities and provisions. 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 audit of the Authority’s financial statements.
VFM conclusion and risk areas	We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2014.

Key financial statements audit risks

Following receipt of the draft financial statements we identified three risk areas – the valuation of Property, Plant and Equipment, the valuation of the Local Government Pension Scheme liability and the disclosures in relation to PFI scheme assets and liabilities.

Following receipt of the draft financial statements we identified three risk areas. 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 Authority.

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
Valuation of PPE	After preparing the first draft of the financial statements the Authority made some changes to the version put on deposit for inspection by the public, mainly to incorporate PPE revaluations not available in time for the first draft. Subsequent to this we were made aware of more revaluations that will be reflected in the final version of the financial statements. In addition to this, we identified some large impairments recognised in the Comprehensive Income & Expenditure Statement (CIES) relating to a small amount assets. We therefore identified a risk over the valuation of PPE due to the incompleteness of valuation information and errors in reflecting valuations in the financial statements.	Our work in this area involved sample testing assets revalued in year to confirm the asset register values reflected the latest valuation certificate, including the large impairments identified in the CIES. We agreed the PPE disclosure note to the asset register to ensure the completeness of the financial statements. We also assessed the reliability of the in-house valuer as management's expert and concluded we could rely on their work. We concluded that the property, plant and equipment balance is not materially misstated. We have requested specific representations from management over the completeness and accuracy of valuations in the asset register.

Section three

Key financial statements audit risks (continued)

The pension liability has a large degree of estimation uncertainty attached to it. We reviewed the reliability of the scheme actuary and the data and assumptions used in the liability calculation and concluded it is not materially misstated.

There are specific disclosure requirements set out in the Code for PFI schemes. We found that the Authority did not fully comply with these requirements in relation to disclosure of estimated future revenue costs.

Key audit risk	Issue	Findings
Valuation of the pension liability	The Authority's share of the Local Government Pension Scheme liability was £818m at 31 March 2014, a reduction of £368m from the previous year. This is determined by the Scheme's actuary, based on several key assumptions which are judgemental in nature. We therefore identified a risk of material misstatement in this balance.	We reviewed the accounts disclosures to the Authority's IAS19 report. We reviewed the key inputs to the valuation, including the information supplied by the Authority to the actuary, including the contributions figures. We assessed the reasonableness of the assumptions used in the calculation and the scheme's actuary AON Hewitt's qualifications as management's expert. We concluded the estimation of the liability was reasonable.
PFI disclosures	Two new PFI schemes were completed in 2013/14 – Holt Park and Little London, Beeston and Holbeck – at which point the Authority recognised the related assets and liabilities on the Balance Sheet. The Code, recognising the accounting complexities and sensitive nature of the schemes, requires several disclosures to be included in the financial statements.	We identified that the Authority had not fully disclosed the full contractual commitment over the life of the schemes; in addition to the liability and interest costs paid over the life of the scheme, the Code also requires the service charge element to be disclosed, which is a significant part of the contract. This has been added to the final version of the financial statements.

Accounts production and audit process

The Authority produced their draft financial statements by the 30 June deadline.

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

Accounts production and audit process

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

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority has once again produced draft financial statements of a good standard. We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 30 June. The Authority made a number of amendments to capital accounting transactions after this date but prior to the start of the audit. Further changes are expected for the final audited version. There is scope to improve the accounts process by ensuring all information is received in time to incorporate it into the draft version prepared by 30 June.
Response to audit queries	Officers resolved the majority of audit queries in a reasonable time and we appreciate their efforts in dealing with these. We did experience some delays in receiving responses back for our PPE revaluation sample.
Quality and timeliness of supporting working papers	Our *Accounts Audit Protocol*, which we issued in January 2014, set out our working paper requirements for the audit. The quality of working papers provided was variable but met the standards specified in our *Accounts Audit Protocol*. We will work with the finance team to address any specific areas where improvements can be made. There is scope to improve the timeliness of working papers by providing these in advance of when we plan to start the task per our work plan. This did not have a significant impact on our progress, as we were able to work around this by bringing forward other audit work.

As a result of the above we have raised a recommendation in respect of the Authority's working papers which is included in Appendix 1.

Follow up of prior year recommendations in respect of the IT control environment

We reported in our *Interim Audit Report 2013/14* that we were yet to complete our testing of IT controls and therefore would report back on the Authority's progress in addressing all prior year recommendations.

We completed our testing of changes to the FMS system during the final accounts audit and concluded that controls are now in place. All prior year recommendation have been addressed.

Completion

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

Before we can issue our opinion we require a signed management representations 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 Leeds City Council for the year ending 31 March 2014, we confirm that there were no relationships between KPMG LLP and Leeds City Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 2 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 for presentation to the Corporate Governance and Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

We are seeking specific representations on the completeness and accuracy of PPE revaluations in the financial statements, and the provision for NNDR appeals.

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 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 Authority's 2013/14 financial statements.

VFM conclusion

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

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

Background

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

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

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

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

Work completed

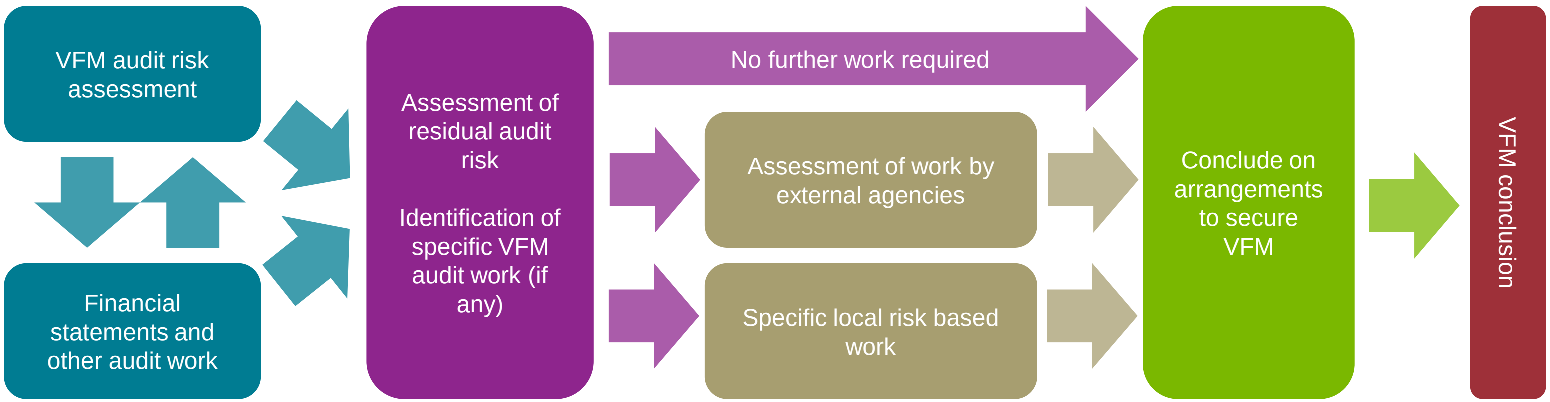
We performed a risk assessment earlier in the year and have reviewed this throughout the year.

We identified one focus area in our External Audit Plan 2013/14, on the Authority's savings plan, which we have monitored throughout the year. We have included an update on this on the next page.

Conclusion

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

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



Specific VFM risks

We have identified a number of specific VFM risks.

In all cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to this focus area is adequate.

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 Authority's key business risks which are relevant to our VFM conclusion;
- identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit; and
- considered the results of relevant work by the Authority, inspectorates and review agencies in relation to these risk areas.

Key findings

Below we set out the findings on our focus area as set out in our *External Audit Plan.* We concluded that we did not need to carry out any further risk based work because the Authority has demonstrated that it was able to meet its savings plans in 2013/14.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
	The Authority set a budget for 2013/14 with a requirement to make further savings of £51 million due to reduced funding and continued cost pressures. This includes a net reduction in staffing equivalent to 388 full-time equivalent posts by the end of 2013/14. The Authority will need to establish and manage its savings plans to secure longer term financial and operational sustainability and ensure that any related liabilities are accounted for in its 2013/14 financial statements as appropriate.	In our Interim Audit Report, issued in June 2014, we reported that the Authority's performance against its budget at month 10 was on track, with a forecast underspend of £3.5m reported at that stage. We therefore did not identify a risk to the VFM conclusion. The outturn position re-enforced this view; a £2.3m underspend was reported after transfers to earmarked reserves totalling £7.2m. We reconciled this figure to the financial statements during our audit to confirm the reliability of this figure. **Specific risk based work required: None**

Appendix 1: Key issues and recommendations

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

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

We will formally follow up these recommendations next year.

Priority rating for recommendations		
❶ ***Priority one***: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	❷ ***Priority two***: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	❸ ***Priority three***: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
1	❸	**WGA submission** The Authority did not comply with the 30 June deadline for the submission of the WGA return to DCLG and auditors, submitting on 15 August due to other competing deadlines. **Recommendation** For future WGA deadlines, the Authority should decide whether it will comply with DCLG's deadlines.	**Management response** The late change to the government's WGA deadline for 2013/14 left the council with insufficient time to reallocate the additional resources that would have been needed to meet it. The council will consult with other authorities and consider its approach to future WGA returns. **Responsible officer** Principal Accountant – Financial Management - Corporate **Due date** 2014/15 accounts process
2	❸	**Availability of working papers** During the course of the audit we were delayed in starting our testing in certain areas due to the unavailability of working papers, for example HRA and WGA. **Recommendation** Working papers should be available in advance of the date we plan to start the work as set out in the work plan.	**Management response** The council will continue to work with KPMG to agree the timing of audit work in advance of the audit, and to provide working papers in line with the agreed timetable. **Responsible officer** Principal Accountant – Financial Management - Corporate **Due date** 2014/15 accounts process

Appendix 2: Declaration of independence and objectivity

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

Requirements

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

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

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

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

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

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from this. These matters should be discussed with the Corporate Governance and 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 2: Declaration of independence and objectivity (continued)

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

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

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

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

Auditor declaration

In relation to the audit of the financial statements of Leeds City Council for the financial year ending 31 March 2014, we confirm that there were no relationships between KPMG LLP and Leeds City Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

cutting through complexity™