# External Audit Report 2015/16

**Leeds City Council**

September 2016

# Contents

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

# Section one: Introduction

**Section one**

# Introduction

**This document summarises:**

- The key issues identified during our audit of the financial statements for the year ended 31 March 2016 for the Authority; 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 2015/16 financial statements; and
- The work to support our 2015/16 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 2015/16*, presented to you in March 2016, set out the four stages of our financial statements audit process.

Planning → Control Evaluation → Substantive Procedures → Completion

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

It also includes any additional findings in respect of our control evaluation in respect of our work on IT controls.

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

## VFM Conclusion

Our External Audit Plan 2015/16 explained our risk-based approach to VFM work. We have now completed our detailed work to support our 2015/16 VFM conclusion. We have:

- Assessed the potential VFM risks and identified the residual audit risks for our VFM conclusion; and
- Considered the results of any relevant work by the Authority and other inspectorates and review agencies in relation to these risk areas; and

## Structure of this report

This report is structured as follows:

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

Our recommendations are included in Appendix 1. We have also reviewed your progress in implementing prior year recommendations.


## Acknowledgements

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

# Section two: Headlines

# Headlines

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

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

| | |
|---|---|
| **Proposed audit opinion** | We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2016. |
| **Audit adjustments** | Our audit has not identified any material audit adjustments, which impact on:<br>— the balance on the general fund as at 31 March 2016;<br>— the deficit on provision of services for the year; or<br>— the net worth of the Authority as at 31 March 2016.<br>Our audit identified and the authority's internal process found a small number of non-material financial and disclosure errors or omissions in the financial statements. The key issues are set out in Section 3 page 9 of this report. |
| **Key financial statements audit risks** | We identified one key financial statements audit risk in our 15/16 External audit plan issued in March 2016 relating to the valuation of Property Plant and Equipment (PPE) .This is a very material value on the balance sheet and it is an estimate based on the professional judgement of your in-house and external valuers.<br>We have worked with officers throughout the year to discuss this key risk and our detailed findings are reported in section 3 of this report. We identified one issue over the valuation of the new PFI Residual Waste Treatment Facility which is discussed in more detail in the Significant Risks table on page 10. |
| **Accounts production and audit process** | We received complete draft accounts by 28 June 2016 in accordance with the DCLG deadline. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code.<br>We have noted an improvement in the quality of the supporting working papers. Officers dealt efficiently with the majority of audit queries and the audit process has been completed within the planned timescales.<br>The Authority has implemented fully or partially all of the recommendations in our *ISA 260 Report 2014/15* relating to the financial statements.<br>As in previous years, we will debrief with the Accounting Team to share views on the final accounts audit. Hopefully this will lead to further efficiencies in the 2016/17 audit process. In particular we would like to thank Authority Officers who were available throughout the audit visit to answer our queries. We identified a number of improvements to your IT arrangements which are detailed in Section 3 on page 14 and are covered in a separate report. We raised one recommendation over the Accounts process shown in Appendix 1. |

# Headlines (cont.)

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

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

| | |
|---|---|
| **VFM conclusion and risk areas** | We identified one significant VFM risk in our External audit plan 2015/16 issued in March 2016 on Financial Resilience.<br>We have worked with officers throughout the year to discuss these VFM risks and our detailed findings are reported in section 4 of this report. There are no matters of any significance arising as result of our audit work in this VFM risk areas.<br>Through the work completed so far, we have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.<br>We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2016. |
| **Completion** | At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas:<br>— PFI assets<br>— Related Party Transactions<br>— Whole of Government Accounts submission<br>You are required to provide us with representations on specific matters such as your going concern assertion and whether the transactions in the accounts are legal and unaffected by fraud. We provided a draft of this representation letter to the Authority and we draw your attention to the requirement in our representation letter for you to confirm to us that you have disclosed all relevant related parties to us.<br>We have requested a specific representation over the valuation of the new PFI Residual Waste Treatment Facility.<br>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. |

# Section three: Financial Statements

# Proposed opinion and audit differences

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

## Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Corporate Governanace and Audit Committee on 16th September 2016.

## Audit differences

In accordance with ISA 260 we are required to report uncorrected audit differences to you. We also report any material misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities. The final materiality level for this year's audit was set at £20 million. Audit differences below £0.6 million are not considered significant. Appendix two provides more detail.

We did not identify any material misstatements. We identified a number of issues that had already been adjusted by management. Of the adjustments identified, the most significant in monetary value are as follows:

— On the Comprehensive Income and Expenditure Statement (CIES) there is a £7.4 million misclassification from Environmental and Regulatory Services to Other Housing Services relating to the transfer of a service between directorates.

— On the CIES there is a £1.7 million misclassification from Cultural and Related Service to Environment and Regulatory Services due to an impairment shown on the wrong line in the draft statements.

— An error in the treatment of Housing Revenue Account dwellings previously classed as Held for Sale increases impairment within gross expenditure by £16.3 million and reduces the Gain or loss on the disposal of Fixed assets by £14.1 million. This also impacts on the Balance Sheet with Assets Held for Sale and the Capital Adjustment Account both reduced by £2.2 million.

— A valuation correction on a school reduces the impairment shown within gross expenditure by £5.7 million on the Children's and Education line, and increases the impairment within the Deficit on Revaluation of Fixed Assets by £2.9 million in the CIES. On the Balance Sheet this adjustment also increases the value of Property Plant and Equipment by £2.8, the impairment of £2.9m is recognised against the Revaluation Reserve and the resulting £5.7m adjustment is taken to the Capital Adjustment Account.

These changes have no impact on the financial position of the Authority.

In addition, we identified a number of presentational adjustments required to ensure that the accounts are compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 ('the Code'). The Authority has addressed these issues where significant.

## Annual governance statement

We have reviewed the Annual Governance Statement and confirmed that:

— It complies with Delivering Good Governance in Local Government: A Framework published by CIPFA/SOLACE; and

— It is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

# Significant audit risks

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

**This section sets out our detailed findings on those risks.**

In our External Audit Plan 2015/16, presented to you in March 2016, we identified one significant risk affecting the Authority's 2015/16 financial statements. We have now completed our testing of this area 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.

**Significant Risk**

Risk

In 2014/15 valuation of PPE was £3.9bn. This is a very material value on the balance sheet and is an estimate based on professional judgement by your in-house valuers. We did see changes to the draft accounts in both 2014/15 when the value of schools was amended following an internal review and 2013/14 when the valuation update was not completed before production of the draft accounts in July.

Findings

During our audit we evaluated the reliability and professional competence of the in-house and external valuer, as management's expert, to consider whether we could rely on their work. We concluded that the valuers have the professional competence, experience and objectivity to provide a valuation of PPE that we can rely on. We also tested a sample of revalued assets to confirm the value of the asset on the fixed asset register reconciled to the valuation report at the date the asset was revalued and the accounting entries were processed correctly in accordance with the Code.

We identified one issue over the valuation of the PFI Residual Waste Treatment Facility disclosed in Note 9 at a cost of £138.8 million which was new in 2015/16. When new assets are completed, buildings are often subject to impairment because the costs of building are often greater than the valuation. Your internal valuers considered the need for an impairment on the Waste Treatment asset concluding that build costs in the PFI model were the most relevant piece of information on which to base the valuation. The professional body RICS, currently do not provide any build cost indices to carry out a full DRC valuation for such a specialised asset. The Council's expert considers that when fully operational for a number of years, there will be clearer evidence in which to consider other valuation methodologies such as an income based approach when this is known.

We have asked management to make a specific representation in respect of this asset to confirm their view of the correct valuation methodology.

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# Significant audit risks

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

**This section sets out our detailed findings on those risks.**

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

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

**Fraud risk of revenue recognition**

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

In our External Audit Plan 2015/16 we reported that we do not consider this to be a significant risk for Local Authorities as there are limited incentives and opportunities to manipulate the way income is recognised since central government is the main source of income.

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

**Management override of controls**

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

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

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

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

# Other areas of focus (cont.)

**In our External Audit Plan 2015/16, presented to you in March 2016, we identified 2 areas of audit focus. These are not considered as significant risks but areas of importance where we would carry out some substantive audit procedures to ensure there is no risk of material misstatement.**

**We have now completed our testing. The table sets out our detailed findings for each area of audit focus.**

**Transport Infrastructure Assets**

A major change to the 2016/17 statements is the application of LAAP Bulletin 100 adopting the measurement requirements of the Transport Code. Assets will be revalued from Historic Cost to Depreciated Replacement Cost supported by detailed Asset Management Records. These are required to provide the detail to support the new valuation a significant change to the arrangements. Ensuring that the necessary records are in place during early 2016 is important to ensure delivery of this change.

Findings

Although this change has not impacted on the 2015/16 financial statements and therefore not applicable to this year's audit opinion, we have continued to monitor progress in setting up the systems to support this change. The Authority has the relevant asset information on the Highways Asset which should form the basis for the accounting records. Work is on-going to establish the most effective interface for the asset record and finance systems.

**Better Care Fund**

The Better Care Fund (BCF) came into operation on 1 April 2015 with £3.46 billion of NHS England's funding to Clinical Commissioning Groups (CCGs) ring-fenced for the establishment of the fund in 2015/16. The Care Act 2014 requires a pooled fund to be established between CCGs and local authorities in the form of a section 75 agreement. Local BCF arrangements may be complex and varied, involving a number of valid commissioning and accounting arrangements that raise risks of misunderstanding, inconsistencies and confusion between members of a BCF pooled budget.

Findings

The Better Care fund is supported by a detailed plan completed jointly by the Council and three Leeds Clinical Commissioning Groups The plan is managed by the BCF Partnership Board which reports to the Leeds Health and Well Being Board. We reviewed the section 75 agreement signed by the Authority and local Clinical Commissioning Groups (CCGs) and assessed the adopted accounting treatment against CIPFA guidance. The Authority accounted for the Better Care Fund transactions on a joint operation basis in line with the guidance and relevant accounting standards.

We discussed the fund with officers to understand how this operates and to confirm the processes in place to capture the financial information. We also reviewed the disclosure at Note 10d showing a total pooled budget of £58.1 million agreeing the note to the Section 75 agreement. We have no matters to report.

# Judgements

We always consider the level of prudence within key judgements in your financial statements. We have summarised our view below using the following range of judgement.

**Level of prudence**

0 1 2 3 4 5 6

Audit difference | Cautious | Balanced | Optimistic | Audit difference

**Acceptable range**

**Assessment of subjective areas**

| Asset/liability class | 15/16 | 14/15 | Balance (£m) | KPMG comment |
|---|---|---|---|---|
| **Provisions** | 3 | 3 | £30.5 million<br>*(PY: £38.4 million)* | Provisions have reduced by £7.9m. This mostly relates to the reduction in the provision for appeals against business rates valuations due to the settlement of outstanding claims. We have reviewed the basis for the calculation for each new provision and consider the provision disclosures to be proportionate and management's judgment to be balanced. |
| **Property, Plant and Equipment (valuations / asset lives)** | 4 | 3 | £4,124.5 million<br>*(PY: £3,854.8 million)* | The overall value of PPE has increased by £269.7m. This increase mostly relates to capital additions in year of £471.2m offset by depreciation of £148.5m, however the net effect of the revaluation in year was an uplift of £25.6m. The majority of assets are revalued by an internal valuer. From our review of your approach to re-valuation and impairment of assets and the reliability of the valuers work, we concluded that a complete list was provided to the valuer and the assumptions used by the valuer were appropriate.<br>As previously discussed in the section on significant risks we identified one specific valuation where we considered the Council's approach to be optimistic for the PFI Residual Waste Treatment Facility which is disclosed in Note 9 at a cost of £138.8 million in 2015/16. Your internal valuers considered the need for an impairment concluding that build costs in the PFI model were the most relevant piece of information on which to base the valuation. The professional body RICS, currently do not provide any build cost indices to carry out a full DRC valuation for such a specialised asset. The Council's expert considers that when fully operational for a number of years, there will be clearer evidence in which to consider other valuation methodologies such as an income based approach when this is known. |
| **Pensions** | 3 | 3 | £961.5 million<br>*(PY: £1,005.8 million)* | The net pension liability has decreased by £44.3m – a decrease of 4%. We reviewed the assumptions underlying the Actuary's valuation of the Authority's pension liability. Our Actuarial specialists concluded that all the financial assumptions used by the Actuary fell within an acceptable range. We have therefore assessed this to be a balanced judgement. |

# 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 could be completed within the planned timescales.**

**The Authority has implemented fully or partially all of the recommendations in our ISA 260 Report 2014/15.**

### 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 effective arrangements in place with a comprehensive set of financial monitoring report in place. |
| **Completeness of draft accounts** | We received a complete set of draft accounts on 28 June 2016. |
| **Quality of supporting working papers** | The quality of working papers provided met the standards specified in our *Accounts Audit Protocol* and improved compared to 2014/15. |
| **Response to audit queries** | Officers resolved audit queries in a reasonable time. |

### Additional findings in respect of the control environment for key financial systems

We have identified the following issues/weaknesses which we would like to bring to your attention:

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### Related Parties

We identified a weakness in the Authority's process for identifying related party transactions which could increase the risk of related party disclosures being incomplete. Appendix One provides further details.

### IT Controls

Whilst controls overall were effective we identified scope to improve specific controls:

- The software change process for SAP Payroll and FMS had not been followed consistently. In a small number of instances SAP Payroll changes had been developed in the live system without appropriate documentation and approval. Testing confirmed that all the changes were appropriate, but the change process had not been followed and approval documentation was incomplete.
- We noted that the SAP Payroll review of user access should be strengthened to review the level of access assigned, to identify staff whose job roles have changed as the access they have will need to be amended. We identified two administrator accounts that had not had access removed when it was no longer required.

A separate report has been drafted which is being agreed with officers and will be reported to the Corporate Governance and Audit Committee at the next meeting

### Prior year recommendations

As part of our audit we have specifically followed up the Authority's progress in addressing the recommendations in last years ISA 260 report. The Authority has implemented fully or partially all of the recommendations in our *ISA 260 Report 2014/15*.

Appendix One provides further details.

# 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 representation letter.**

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

## Declaration of independence and objectivity

As part of the finalisation process we are required to provide you with representations concerning our independence.

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

We have provided a detailed declaration in Appendix three in accordance with ISA 260.

## Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Deputy Chief Executive for presentation to the Corporate Governance and Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

## Other matters

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

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

# Section four: Value for Money

# VFM Conclusion

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

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

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

## Background

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

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

The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria.

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

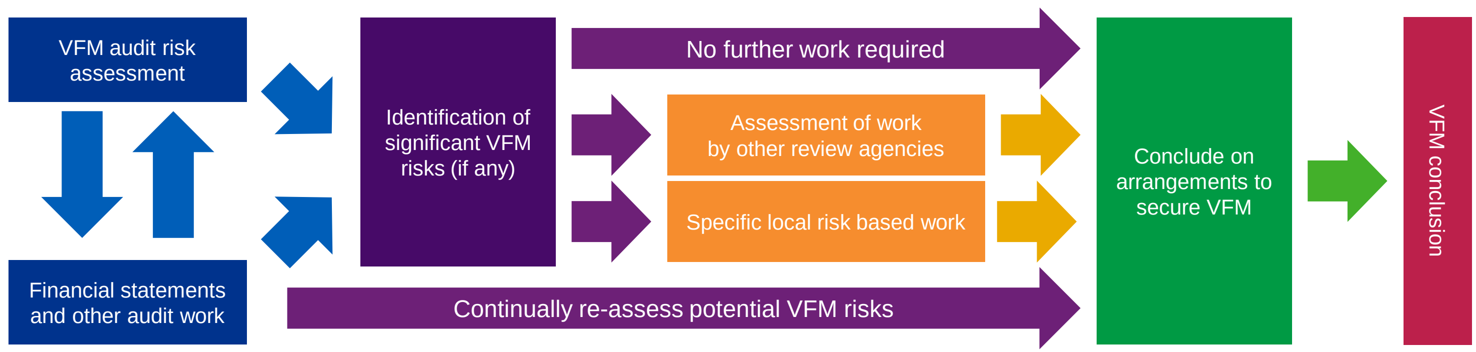
## Conclusion

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

**Overall criterion**

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

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



# Specific VFM Risks

**We have identified a number of specific VFM risks.**

**In most cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are 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;

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

— Completed specific local risk based work.

## Key findings

Below we set out the findings in respect of those areas where we have identified a residual audit risk for our VFM conclusion.

We concluded that we needed to carry out additional work for some of these risks. The majority of this work is now complete and we report on this below.

# Specific VFM Risks (cont.)

**We have identified a number of specific VFM risks.**

**In most cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate**

| Key VFM risk | Risk description and link to VFM conclusion | Assessment |
|---|---|---|
| The Financial pressures facing the Authority may impact on sustainable resource deployment | There are significant financial pressures facing the Authority. General Reserves were £29.6 million in 2010/11 and were expected to reduce to £20.9 million by the end of March 2016. Although the Actual closing position was slightly better at £21.5 million by March 2016 there continues to be significant budget pressures.<br><br>Business rate appeals are also creating further pressure on the financial position increasing the Authority's share of the collection fund deficit to £32.3million at the end of March 2016 compared to £27.6million at 31 March 2015. | In 2015/16 the Authority had a net budget for service expenditure of £523.8 million and this was supported by the agreed usage of £1.5m of general reserves. The Authority has met its financial target during the year with some overspend in Children's Services offset by underspend in the Environment and Housing, and Citizen's and Communities directorates. Overall, there was an underspend against the budget of £0.7 million in 2015/16, reducing the funding from reserves requirement to £0.8 million.<br><br>In July the Authority reported forecasted a £2.9 million budget overspending on revenue Budgets by the end of the 2016/17 with underlying pressures in the demand-led budgets in Children's Services and Adult Social Care. However, we understand that the Authority is committed to bringing-forward actions to reduce the potential overspend in 2016/17 and enable a balanced budget.<br><br>We have reviewed the financial planning arrangements in place at the Authority and have confirmed that these are appropriate. There is a detailed service and policy review process in place which will lead to the updated medium-term financial strategy being presented to the Executive Board's September meeting as part of the decision on whether or not to accept this four-year settlement.<br><br>The Authority has identified that £110 million of savings will be required over the next three years to 2019/20 based on the budget offer by DCLG. The Authority recognises the financial challenge which is heavily front loaded, requiring £82 million of savings in 2017/18, and is considering how reserves can be used to support the budget over the next three years. Whilst a significant proportion of the savings have been identified the Council still needs to identify some £18m of savings to balance the medium-term strategy. We have reviewed the high level assumptions used by the Authority to prepare its budget and have found these to be in line with our knowledge and expectations. The Authority recognises the risks in relation to the use of assumptions, some of which have the potential to cause a significant impact to the budget if they are not robust, and it will need to keep these under review over the coming months.<br><br>There is no overall impact on the overall VFM Conclusion. |

# Appendices

# 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 | ❷ | **Related Party Transactions**<br>There is no process to identify transactions between the Authority and commercial organisations that are related to councillors or senior officers as part of the accounts process. Audit testing was carried out in 2015/16 to ensure that there were no such transactions that were material to the Authority or the related party required disclosure<br>**Recommendation**<br>We recommend that the council reviews such transactions as part of the accounts process. | **Management Response**<br>The Authority's current approach to the disclosure of related parties for Members and Senior Officers was agreed with a previous KPMG team some years ago, as part of the drive to encourage simpler local authority accounts. Given the change in emphasis from the current KPMG team, the Council will review its approach to the disclosure of related parties for the 2016/17 accounts.<br>**Responsible officer**<br>Principal Financial Manager<br>May 2017. |

# Follow up of prior year recommendations

**The Authority has implemented two of the three recommendations in our *ISA 260 Report 2014/15*.**

This appendix summarises the progress made to implement the recommendations identified in our ISA 260 Report 2014/15 and re-iterates any recommendations still outstanding.

| Number of recommendations that were: | |
|---|---|
| **Included in original report** | 3 |
| **Implemented in year or superseded** | 2 |
| **Remain outstanding (re-iterated below)** | 1 (partial) |

| No. | Risk | Issue and recommendation | Officer responsible and due date | Management response and status |
|---|---|---|---|---|
| 1 | ❸ | **Availability of Working Papers**<br>Whilst we have noted an improvement in the quality and timeliness of production of working papers, during the course of the audit there were some delays in starting our testing in certain areas due to the availability of working papers, for example valuation reports for Property, Plant and Equipment, and data requests relating to Staff Expenses.<br>**Recommendation**<br>Working papers should be available in advance of the date we plan to start the work as set out in the work plan. | **Responsible officer**<br>Principal Financial Manager (Corporate Financial Management)<br>**Due date**<br>2015/16 accounts process. | **Management Response**<br>Implemented. - The availability of working papers has further improved during the 2015/16 process. No issues have been noted with the quality or timeliness of working papers. |

# Follow up of prior year recommendations (cont.)

**Prior year recommendations continued.**

| No. | Risk | Issue and recommendation | Officer responsible and due date | Management response and status |
|---|---|---|---|---|
| 2 | 3 | **3 Way Matching of Invoice types IN and IS**<br>We were unable to rely upon 3 way matching (invoice to purchase order to goods received note) of invoice types IN and IS as a control during the course of our audit This was because we were only able to match 27% of these invoices to their purchase orders and good received notes. Of this 27%, only 59% matched by value.<br>**Recommendation**<br>The Authority should review their procedures around 3 way matching of these invoice types, and consider whether they are appropriate, whether they clearly state when it is appropriate to not have a 3 way match, and whether they are being followed. | **Responsible officer**<br>Head of Financial Services (Business Support Centre)<br>**Due date**<br>March 2016 | **Management response**<br>The council's review of ordering processes is ongoing, and during the year has identified further possible areas where an individual order may not be required due to the existence of a contract. As requested by KPMG, the council has investigated the feasibility of enabling automatic tagging of such invoices. However it was found that any such tagging would require manual input, and would therefore not be 100% reliable. Given that introducing such a change would involve costs of a system development and would lead to an ongoing additional workload for processing each invoice, the council does not feel that this would be justified. The council remains satisfied that it has procedures in place to ensure that invoices are only paid when they have been properly authorised, and that the issue identified by KPMG is one of enabling global reporting of this. |

# Follow up of prior year recommendations (cont.)

**Prior year recommendations continued.**

| No. | Risk | Issue and recommendation | Officer responsible and due date | Management response and status |
|---|---|---|---|---|
| 3 | 3 | **Access to Approve Purchase Orders on FMS**<br>We identified issues with access rights to approve purchase orders on FMS during the course of our audit. These issues fell into three categories:<br>— It had been agreed that service user functions (such as approving purchase orders) should be removed from finance officers, however this has not yet been implemented. Although this has been agreed in principal, a conscious decision was made by the Authority not to implement this until the six monthly review in Autumn 2015.<br>— When the ALMOs were brought back in house and therefore users roles had changed, these roles are still to be finalised and therefore the related access rights are still under review to determine whether they are appropriate.<br>— Users at schools had been inappropriately granted access to approve purchase orders as part of the standardisation process. Schools determine their own policies around FMS access, and therefore shouldn't have been included in this exercise.<br>**Recommendations**<br>Timescales should be set for implementing the decision to remove service user functions for finance officers.<br>FMS access rights for staff who came in house from the ALMOs should be reviewed to check whether their historic access rights which were carried over are still appropriate.<br>Any future automated implementation of standardised access rights should be reviewed carefully to ensure it is appropriate for all groups of users on FMS. | **Responsible officer**<br>Principal Financial Manager (Corporate Financial Management)<br>**Due date**<br>September 2015 | **Management response**<br>Access rights of finance officers to carry out service user functions are being removed as part of the 6 monthly user access review which commenced in August 2015. Restructures arising from the transfer of former ALMO staff have now been completed, and any remaining changes to these staff's FMS access rights are being picked up as part of the same exercise. We will ensure that school staff are excluded from any future standardisation exercises<br>**Status**<br>Implemented - No issues relating to the access rights of finance officers were identified during the 2015/16 audit. |

# Materiality and reporting of audit differences

**For 2015/16 our materiality is £20 million for the Authority's accounts.**

**We have reported all audit differences over £0.6 million for the Authority's accounts.**

## Materiality

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

— Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.

— Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.

— Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We used the same planning materiality reported in our External Audit Plan 2015/16, presented to you in March 2016.

Materiality for the Authority's accounts was set at £20 million which equates to around 1.1 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

## Reporting to the Audit Committee

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

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

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

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £0.6m million for the Authority.

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

# Declaration of independence and objectivity

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

## Requirements

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

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

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Public Sector Audit Appointments Ltd *Terms of Appointment* ('Public Sector Audit Appointments Ltd Guidance') and the requirements of APB Ethical Standard 1 *Integrity, Objectivity and Independence* ('Ethical Standards').

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

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

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from his. These matters should be discussed with the Audit Committee.

Ethical Standards require us to communicate to those charged with governance in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on our independence and the objectivity of the Engagement Lead and the audit team.

# Declaration of independence and objectivity (cont.)

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

## General procedures to safeguard independence and objectivity

KPMG's reputation is built, in great part, upon the conduct of our professionals and their ability to deliver objective and independent advice and opinions. That integrity and objectivity underpins the work that KPMG performs and is important to the regulatory environments in which we operate. All partners and staff have an obligation to maintain the relevant level of required independence and to identify and evaluate circumstances and relationships that may impair that independence.

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

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

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

## Auditor declaration

In relation to the audit of the financial statements of Leeds City Council for the financial year ending 31 March 2016, 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 Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

## Audit Fees

Our scale fee for the audit was £231,953 plus VAT (£309,270 in 2014/15). This fee was in line with that highlighted within our audit plan agreed by the Audit Committee in March 2016. Our scale fee for certification for the HBCOUNT is £15,923 plus VAT (£22,140 in 2014/15).

## Non-audit services

We have provided no non-audit services in 2015/16.

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