External audit report 2016/17

Leeds City Council

September 2017

Summary for Audit Committee

Financial statements

This document summarises the key findings in relation to our 2016-17 external audit at Leeds City Council.

This report focusses on our on-site work which was completed in July and August 2017 on the Authority's significant risk areas, as well as other areas of your financial statements. Our findings are summarised on pages 4 – 5.

We did not identify any material misstatements. However, we have reported a number of adjustments identified by management. The three significant audit adjustments, of which one was material, are documented in Appendix 3. See page 24 for details.

Based on our work, we have raised one recommendation. Details on our recommendations can be found in Appendix 1.

We are close to the completion stage of the audit, however the following is still outstanding:

- An assessment the appropriateness of adopting the HRA adjustment factor for housing stock valuations in line with regional variables
- LOBO objection review

Once we have done sufficient work to be confident that the outcome of the LOBO objection will not have a material impact on the Authority's accounts and subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's financial statements before the deadline of 30 September.

We anticipate issuing our completion certificate and Annual Audit letter once our work on the outstanding LOBO objection is complete.

Use of resources

We have completed our risk-based work to consider whether in all significant respects the Authority has proper arrangements to ensure it has taken properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. 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 value for money conclusion.

See further details on page 15.

Public Interest Report

We have a duty to consider whether to issue a report in the public interest about something we believe the Authority should consider, or if the public should know about.

Acknowledgements

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

We ask the Audit Committee to note this report.

KPMG

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Contents

Section one

Financial Statements

We anticipate issuing an unqualified audit opinion on the Authority's 2016/17 financial statements by 30 September 2017. We will also report that your Annual Governance Statement complies with the guidance issued by CIPFA/SOLACE (*'Delivering Good Governance in Local Government'*) published in April 2016.

Due to an outstanding local elector objection in respect of the 2016/17 financial statements, we do not anticipate being able to issue a certificate to close the audit.

For the year ending 31 March 2017, the Authority has reported a surplus on the provision of services of £327m. There has been an overall decrease in the General Fund.

Significant audit risks

Our *External Audit Plan 2016/17* sets out our assessment of the Authority's significant audit risks. We have completed our testing in these areas and set out our evaluation following our work:

Significant audit risks	Work performed
1. Significant changes in the pension liability due to LGPS Triennial Valuation	**Why is this a risk?** During the year, the Local Government Pension Scheme for West Yorkshire Pension Fund (the Pension Fund) has undergone a triennial valuation with an effective date of 31 March 2016 in line with the Local Government Pension Scheme (Administration) Regulations 2013. The Authority's share of pensions assets and liabilities is determined in detail, and a large volume of data is provided to the actuary in order to carry out this triennial valuation. The pension liability numbers to be included in the financial statements for 2016/17 will be based on the output of the triennial valuation rolled forward to 31 March 2017. For 2017/18 and 2018/19 the actuary will then roll forward the valuation for accounting purposes based on more limited data. There is a risk that the data provided to the actuary for the valuation exercise is inaccurate and that these inaccuracies affect the actuarial figures in the accounts. Most of the data is provided to the actuary by Bradford City Council who administer the Pension Fund. **Our work to address this risk** We have reviewed the process used to submit payroll data to the Pension Fund and tested the year-end submission process and have found no significant issues that we wish to report. We have also agreed the total figures submitted to the actuary to the ledger with no issues arising. We have obtained assurances from the Pension Fund auditors over the valuation of the overall scheme asset and liability valuations. The fund auditor has observed that the value of total fund asset investments is understated by £43.2m KPMG are awaiting confirmation from Mazars on this position. This value is however split across all fund members and we have been able to confirm that the impact on Leeds reported pension positon is not material. To gain assurance over the assumptions used in the scheme, we have engaged KPMG's pensions team. They have reviewed the assumptions used by the actuary in reaching their valuation and have confirmed that these are in line with their expectations. The assumptions are reviewed for appropriateness by the Pension Fund administering authority and by the accounts teams at the participating Authorities who are members of the scheme.

Significant audit opinion risks	Work performed
2. Valuation of PPE	**Why is this a risk?** In accordance with the Code, all valuations are subject to review as part of a five year rolling revaluation programme. In order to reflect a more accurate value of the authority's assets any asset which is not revalued in the year or not included at either cost or nominal value is uplifted based on appropriate indices. As at 31 March 2017, the net book value (NBV) of PPE was £4,685 million. Given the significance of the balance there is a greater risk of material misstatement in the financial statements. We have therefore identified this a significant audit risk which we addressed using the approach outlined below. **Our work to address this risk** We undertook the following work over the valuation of material land and building balances: • assessed the competence, capability, objectivity and independence of the internal valuers. • critically assessed the calculation of market value indices movements used, including a re-performance of this calculation to confirm that any material movement in the value of land and building assets was indicated appropriately reflected market conditions. The market value indices used were in line with the regional indices provided by Gerald Eve. • critically assessed the appropriateness of the Authority's decision to adopt of the HRA adjustment factor, provided by DCLG, which saw a significant change from the value used as at 31 March 2016. The adjustment factor is applied to the Beacon Value to calculate the Existing use value for social housing (EUV-SH). We are satisfied the adjustment factor applied is in line with sector norms. <u>At the time of writing we are awaiting the evidence to support this conclusion.</u> • critically assessed the Authority's formal consideration of indications of impairment within its estate, including the process undertaken and the adequacy of the documentation used in the process. This was adequate for the purposes of the audit. • considered the adequacy of the disclosures about the key judgements and degree of estimation involved in concluding any change in value of land and buildings since 31 March 2016. These were appropriate. • In addition, we have consulted KPMG's internal valuation specialists to determine the appropriateness of the valuation methodology applied to waste PFI assets. Our work has not identified any material errors, we have however raised one medium priority recommendation in respect of the authorities internal review of valuations used for the purposes of preparing the annual accounts. Further details can be found at appendix 1.

Considerations required by professional standards

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 2016/17* we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue.

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

Management override of controls

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

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

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

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

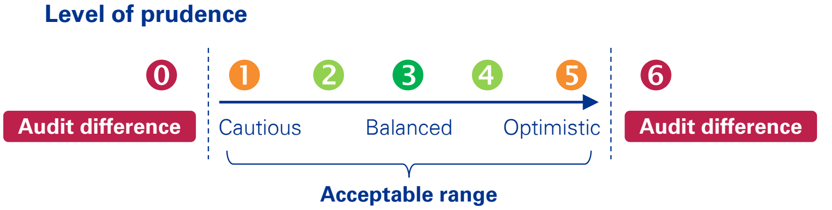
Other areas of audit focus

We identified an area of audit focus. This is not considered a significant risks as it is less likely to give rise to a material error. Nonetheless this is an area of importance where we would carry out substantive audit procedures to ensure that there is no risk of material misstatement.

Other areas of audit focus	Our work to address the areas
1. Disclosures associated with retrospective restatement of CIES, EFA and MiRS	**Background** During past years, CIPFA has been working with stakeholders to develop better accountability through the financial statements as part of its 'telling the whole story' project. The key objective of this project was to make Local Government accounts more understandable and transparent to the reader in terms of how Local Authorities are funded and how they use their funding to serve the local population. The outcome of this project resulted in two main changes in respect of the 2016-17 Local Government Accounting Code (Code) as follows: — Allowing local authorities to report on the same basis as they are organised by removing the requirement for the Service Reporting Code of Practice (SeRCOP) to be applied to the Comprehensive Income and Expenditure Statement (CIES); and — Introducing an Expenditure and Funding Analysis (EFA) which provides a direct reconciliation between the way local authorities are funded and prepare their budget and the CIES. This analysis is supported by a streamlined Movement in Reserves Statement (MIRS) and replaces the current segmental reporting note As a result of these changes, retrospective restatement of CIES (cost of services), EFA and MiRS is required from 1 April 2016 in the Statement of Accounts. New disclosure requirements and restatement of accounts require compliance with relevant guidance and correct application of applicable Accounting Standards. Though less likely to give rise to a material error in the financial statements, this is an important material disclosure change in this year's accounts, worthy of audit understanding. **What we have done** As part of our audit: — We have assessed how the Authority has actioned the revised disclosure requirements for the CIES, MiRS and the new EFA statement as required by the Code; and — We checked the restated numbers and associated disclosures for accuracy, correct presentation and compliance with applicable Accounting Standards and Code guidance. We can confirm that the EFA statement has been disclosed in line with the Code and the restatement of the MIRS and CIES is complete and accurate.

Judgements

We have considered the level of prudence within key judgements in your 2016/17 financial statements and accounting estimates. We have set out our view below across the following range of judgements.



Subjective areas	2016/17	2015/16	Commentary
Provisions	3	3	We consider the provision accounting treatment and disclosures to be proportionate. The position on provisions in the draft accounts has changed, as will be discussed in the audit adjustments section of the report. However, we consider this approach to be prudent and reflective of the requirements of the accounting standards and the Code.
PPE: HRA assets	3	3	The Authority continues its use of the beacon methodology in line with the DCLG's *Stock Valuation for Resource Accounting* published in November 2016. The Authority has utilised the internal valuation expert to provide valuation estimates. We have reviewed the instructions provided and deem that the valuation exercise is in line with the instructions. The increase in valuation is in line with expectations, however, we challenged the Authority during the audit on their justification for adoption of the adjustment factor stipulated by DCLG. They subsequently provided supported evidence demonstrating consistency with the surrounding region.
PPE: Valuation of PPE	3	3	The overall value of PPE has increased by £560.3m. This increase mostly relates to revaluation in year of £458m (of which £443m relates to HRA assets), together with capital additions of £313.2m offset by depreciation of £93.3m. The majority of assets are revalued by the internal valuers. From our review of your approach to re-valuation and impairment of assets, and the reliability of the values' work, we concluded that a complete list was provided to the valuers and the assumptions used by the valuers were appropriate.

Proposed opinion and audit differences

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's 2016/17 financial statements following approval of the Statement of Accounts by the Audit Committee on 22 September 2017. However, will be unable to issued the completion certificate until the LOBO objection work is finalised.

Audit adjustments

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 (see Appendix 4 for more information on materiality) level for this year's audit was set at £18 million in line with the Audit Plan. Audit differences below £600k are not considered significant.

The audit team did not identify any material misstatements. However, some adjustments have been made from the draft version of accounts that were identified by the client during the course of the audit.

The net impact on the General Fund and HRA as a result of the three adjustments is to decrease the balance as at 31 March 2017 by £1.084 million. This is mainly the result of the amendments documented in Appendix 3.

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 2016/17 ('the Code').

We understand that the Authority will be addressing these and updating the accounts as appropriate. We will confirm the required amendments have been made in the final accounts.

Annual governance statement

We have reviewed the Authority's 2016/17 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.

Narrative report

We have reviewed the Authority's 2016/17 narrative report and have confirmed that it is consistent with the financial statements and our understanding of the Authority.

Accounts production and audit process

Our audit standards (*ISA 260*) require us to communicate our views on 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. The efficient production of the financial statements and good-quality working papers are critical to meeting the tighter deadlines.

Accounting practices and financial reporting

The Authority has recognised the additional pressures which the earlier closedown in 2017/18 will bring. We have been engaging with the Authority in the period to address issues as they emerge. The Authority have made a positive start and met the required deadline of 30th May this year. Through effective debrief and detailed planning we will need to ensure the Authority is again in the best possible position to meet the Faster Close requirements in 2017/18, which includes conclusion of the audit process by 31 July 2018.

Completeness of draft accounts

We received a complete set of draft accounts on 13 June 2017.

Quality of supporting working papers

We issued our *Accounts Audit Protocol 2016/17* ("Prepared by Client" request) in June 2017 which outlines our documentation request. This helps the Authority to provide audit evidence in line with our expectations. We will endeavour to issue this documentation request earlier in 2017/18.

We did not find quality issues in relation to the working papers. There is an opportunity for improvements to be made in providing further breakdowns of underlying transactions, for example debtor and creditors, which will be reflected in next year's prepared by client protocol.

Response to audit queries

We are pleased to report that Officers have been responsive to our queries. As a result of this, our audit work was completed within the timescales expected with no significant outstanding queries. As stated earlier, we are still waiting on the Authority's assessment on the appropriateness of adopting the HRA regional adjustment factor in line with regional norms.

Further detail and associated recommendations can be found in Appendix 1.

Additional findings in relation to the Authority's control environment for key financial systems

We have tested controls as part of our focus on significant audit risks and other parts of your key financial systems on which we rely as part of our audit. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

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 all of the recommendations in our ISA 260 Report 2015/16.

Appendix 2 provides further details.

Controls over key financial systems

We have tested controls as part of our focus on significant audit risks and other parts of your key financial systems on which we rely as part of our audit. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

Controls of IT systems

We have tested IT controls as part of the annual audit process. As well as placing reliance on manual controls over finance systems, we are required to place reliance on automated controls and system generated reports which inform our overall controls approach.

We will present our findings in a separate report to the Audit Committee. Overall, we concluded that IT controls were operating effectively and sufficient to allow audit to place reliance on them.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's 2016/17 financial statements.

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

We are currently considering an elector objection in respect of LOBO borrowing and as a result do not anticipate being able to issue an audit closure certificate until our work on this issue has concluded.

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 2017, 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.

We have provided a detailed declaration in Appendix 5 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 Principal Financial Manager for presentation to the Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

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

- Significant difficulties encountered during the audit;
- Significant matters arising from the audit that were discussed, or subject to correspondence with management;
- Other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process; and
- Matters specifically required by other auditing standards to be communicated to those charged with governance (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 other 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 financial statements.

Elector objection

During the audit, and in line with several other Local Authorities this year, we have received an objection in respect of the Authority's Lender Option, Borrower Option (LOBO) borrowing activity. The objection relates to lawfulness of this type of borrowing instrument and the Authority's treasury management decision making processes.

We are hopeful of doing sufficient work to ensure that this issue will not delay our ability to issue an opinion on the Authority's financial statements in line with the 30 September audit deadline. However this decision is dependent on us confirming that irrespective of the outcome of the objection (e.g. LOBO borrowing was deemed to be unlawful), it would not have a material impact on the Authority's 2016/17 financial statements.

It is however unlikely that this objection will be resolved by the 30 September audit deadline and as such do not anticipate being able to issue an audit closure certificate until our work on this has concluded.

Section two

Value for money

Our 2016/17 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 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.

The table below summarises our assessment of the individual VFM risks identified against the three sub-criteria. This directly feeds into the overall VFM criteria and our value for money opinion.

VFM assessment summary

VFM risk	Informed decision-making	Sustainable resource deployment	Working with partners and third parties
1. Financial standing	✓	✓	✓
Overall summary	✓	✓	✓

In consideration of the above, we have concluded that in 2016/17, 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.

Further details on the work done and our assessment are provided on the following pages.

VFM conclusion

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.'

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.

1 Identification of significant VFM risks (if any)

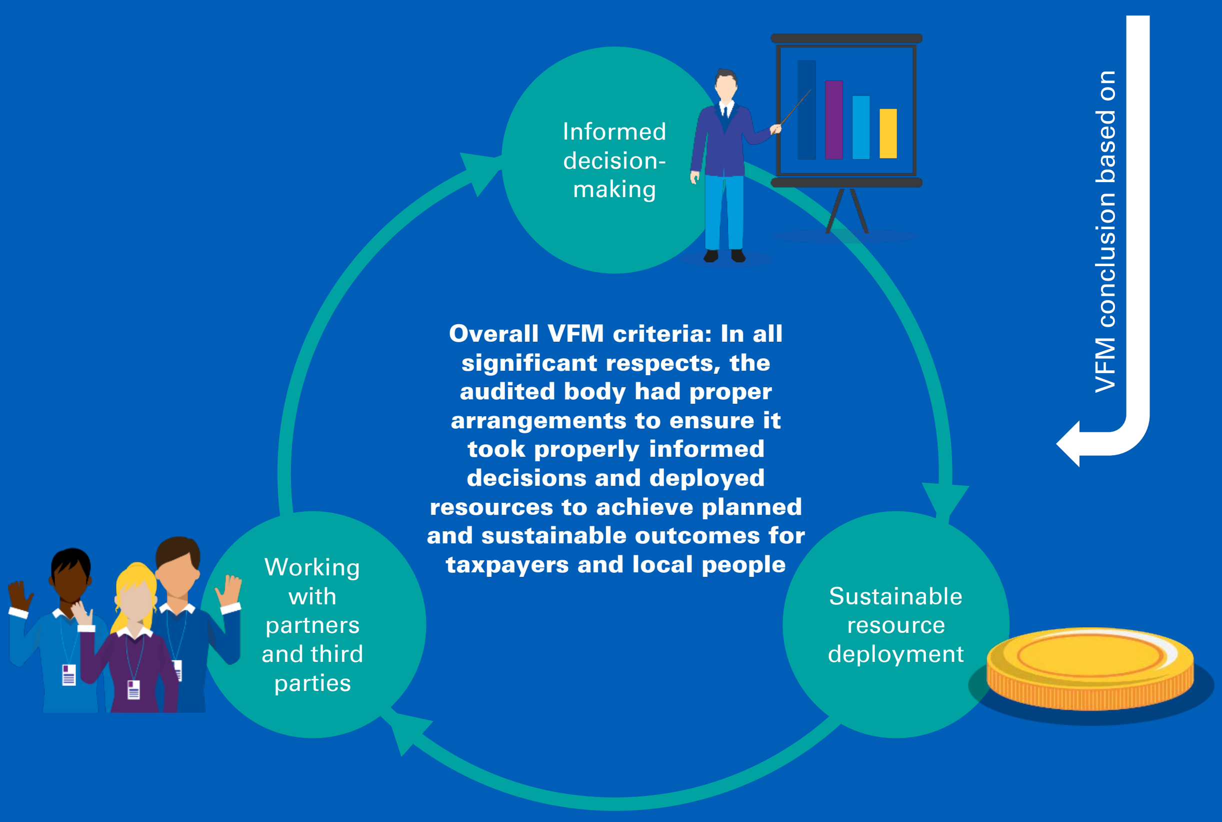
- VFM audit risk assessment
- Financial statements and other audit work

2 Continually re-assess potential VFM risks

- Assessment of work by other review agencies
- Specific local risk-based work

3 VFM conclusion

- **Conclude on arrangements to secure VFM**



Significant VFM risks

We have identified two significant VFM risks, as communicated to you in our *2016/17 External Audit Plan*. In all 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.

Significant VFM risks	Work performed
1. Financial Standing	**Why is this a risk?** There are significant financial pressures facing the Authority. General reserves were estimated to be £18.1 million at 31st March 2017, reducing from £21.6m million as at 31 March 2016. At month 9, a £0.9m overspend was forecast, the main pressures arising from Children's Services (£6.64m) being offset by a £5.4m underspend in the Strategic and Central Directorate. Between the 2010/11 and 2016/17 budgets, the Authority's core funding from government has reduced by around £214m and in addition, the Authority has faced significant demand-led cost pressures. This means that the Authority will have to delivered reductions in expenditure and increases in income totalling over £400m by 31 March 2017. Given the significant financial pressures facing the Authority and the need to deliver £81.8m of savings by 31 March 2018, this has been identified a value for money risk. Given the Authority's strong track record, it is confident that the required savings in 2017/18 will be achieved. **Summary of our work** The Authority reported an underspend of £2.0m on the £496.4m budget for service expenditure at 31 March 2017. As the 2016/17 budget was supported by the agreed usage of £3.4m of general reserves, this underspend reduced the required amount of reserves to fund the budget to £1.4m. This favourable outturn reflects the robust budgetary controls in place at the Authority. However, despite considerable savings since 2010, the budget for 2017/18 requires the Council to deliver a further £64m of savings. At this early stage of the financial year, the financial monitoring report for quarter one indicated the majority of the actions to deliver these savings are on track. However, the report highlights a potential overall overspend of £2.9m and measures will need to be identified and implemented so that a balanced budget position can be delivered. Through our VFM work, we have considered how the Authority is managing its savings plans to assess whether this has had an unintended adverse impact on service delivery. We have reviewed the high level assumptions and substantively reviewed progress against achievement of a sample of individual savings proposals used by the Authority to prepare its budget. We 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. We assessed the level of reserves available at 31 March 2017 against the Authority's reserves policy, taking into account any contingent liabilities which could have a significant impact on the Authority's financial standing if they were to crystallise. The Authority have demonstrated they have managed the level of reserves effectively in recent years despite the budgetary pressures they face. overall we consider the Authority to have adequate arrangements in place regarding the management of its financial risks and potential impact on resource deployment.

Appendices

Key issues and recommendations

Our audit work on the Authority's 2016/17 financial statements have identified one issue. We have listed this in the appendix together with our recommendation which we have agreed with Management. We have also included Management's responses to these recommendations.

The Authority should closely monitor progress in addressing the risks, including the implementation of our recommendations. We will formally follow up these recommendations next year.

Each issue and recommendation have been given a priority rating, which is explained below.

High priority — 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.

Medium priority — 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.

Low priority — Issues that would, if corrected, improve internal control in general but are not vital to the overall system. These are generally issues of good practice that we feel would benefit if introduced.

The following is a summary of the issues and recommendations raised in the year 2016/17.

2016/17 recommendations summary

Priority	Number raised in our interim report	Number raised from our year-end audit	Total raised for 2016/17
High	0	0	**0**
Medium	0	1	**1**
Low	0	0	**0**
Total	**0**	**1**	**1**

Medium priority

1. Critically challenging asset valuation assumptions

During the audit we identified there is no formal documentation in place which evidences management challenge of the assumptions adopted by internal valuers.

For example, in 2016/17, we challenged the indices applied to the non-rolling valuation programme assets and the rationale for using MEA (modern equivalent asset valuation) as a basis for DRC (Depreciation Replacement Cost).

We are satisfied that management have challenged and understood the basis for these changes, however, documented evidence was not provided to support this review.

In addition, we specifically requested the Authority provide evidence to demonstrate the Authority's Housing Stock was consistent in type and nature to the region to establish whether adoption of the regional adjustment factor was appropriate.

Without formal documentation of review, there is no evidence to demonstrate management's challenge of the valuers assumptions and that sufficient review of the process has taken place.

Recommendation

The Authority have demonstrated there is a process in place to challenge assumptions, identify impairments and changes in asset classification. This process is documented in a procedure note.

Whilst, we have reviewed elements of this throughout our audit work, in preparation for next year, the Authority should bring a formal review of assumptions and impairment together into one paper, with supporting evidence, to make for an effective audit trail.

In light of Faster Close, this will ensure Central Finance are fully assured over asset values in the year end accounts, and this can be easily evidenced for the audit team to review.

Management Response

The council will look at ways to ensure that discussions during the valuation process between the corporate finance team and the council's valuers in Asset Management are more fully documented

Owner

Principal Financial Manager (Corporate Financial Management);

Deadline

May 2018

Follow-up of prior year recommendations

In the previous year, we raised two recommendations which we reported in our *External Audit Report 2015/16 (ISA 260)*. The Authority has implemented two of the recommendations. We re-iterate the importance of the outstanding recommendations and recommend that these are implemented by the Authority.

We have used the same rating system as explained in Appendix 1.

Each recommendation is assessed during our 2016/17 work, and we have obtained the recommendation's status to date. We have also obtained Management's assessment of each outstanding recommendation.

Below is a summary of the prior year's recommendations.

2015/16 recommendations status summary

Priority	Number raised	Implemented / superseded	Outstanding
High	0	0	**0**
Medium	2	2	**0**
Low	0	0	**0**
Total	**2**	**2**	**0**

Medium priority

1. Related Party Transactions

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

Recommendation

We recommend that the council reviews such transactions as part of the accounts process.

Management original response

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.

Original deadline

May 2017

KPMG's September 2017 assessment

Fully implemented

Medium priority

2. Valuation of the PFI Residual Waste Treatment Facility

Recommendation

A detailed valuation needs to take place on a Depreciated Replacement Cost basis and supported by an appropriate valuation certificate.

Management original response

Officers will consider the need for a detailed valuation as part of the 2016/17 financial statements preparation.

Original Deadline

May 2017

KPMG's September 2017 assessment

The Authority continues to use actual costs incurred as a proxy for a depreciated replacement cost valuation. Management has demonstrated that interest costs have not been capitalised in respect of this site and have confirmed that the site will form part of the five yearly revaluation programme.

We have consulted with KPMG's valuation specialists and have obtained confirmation that for such a specialist building, the approach taken is not unreasonable. Management should however give early consideration of the methodology to be followed when the formal valuation is required.

Audit differences

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

A number of minor amendments focused on presentational improvements have also been made to the 2016/17 draft financial statements. The Finance team is committed to continuous improvement in the quality of the financial statements submitted for audit in future years.

Adjusted audit differences

The following table sets out the significant audit differences identified, by the client during the course of the audit of Leeds City Council's financial statements for the year ended 31 March 2017. It is our understanding that these will be adjusted. However, we have not yet received a revised set of financial statements to confirm this.

Table 1: Adjusted audit differences (£'000)

No.	Income and expenditure statement	Reserves	Assets	Liabilities	Basis of audit difference
1	Dr Net cost of services 17,179 Dr (Surplus) / deficit on revaluation of fixed assets 2,823	Dr Revaluation Reserve 2,823 Dr Capital Adjustment Account 17,179	Cr PPE 20,002		A difference arose during the manual transposition of assets under construction balances from the asset register database to FMS.
2	Dr Net cost of services 4,475	Cr Collection Fund Adjustment Account 2,193		Cr Provisions 2,193	The business rates appeals provision has been updated to reflect the latest information from the Valuation Office Agency as at 31 July 2017.
3	Dr Net cost of services 1,084	Dr General Fund Reserve 1,084		Cr Provisions 1,158 Dr CRC Licences 74	Change in recognition for CRC provision for street lighting
	Dr CIES 25,561	**Dr Reserves 19,462**	**Cr Assets 20,002**	**Cr Liabilities 3,277**	

Materiality and reporting of audit differences

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

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

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

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

We reassessed materiality for the Authority at the start of the final accounts audit. It was a reduced by £2m from £20m to reflect the reduction in General Fund Reserves as at 31 March 2017. Materiality for the Authority's accounts was therefore set at £18m million which equates to around two 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 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.

Appendix 5

Declaration of independence and objectivity

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.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Partners and staff annually confirm their compliance with our Ethics and Independence Manual including in particular that they have no prohibited shareholdings.

Our Ethics and Independence Manual is fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through: Instilling professional values, Communications, Internal accountability, Risk management and Independent reviews.

We would be happy to discuss any of these aspects of our procedures in more detail.

Auditor declaration

In relation to the audit of the financial statements of Leeds City Council for the financial year ending 31 March 2017, 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.

Appendix 5

Non-audit work and independence

Below we have listed the non-audit work performed and set out how we have considered and mitigated (where necessary) potential threats to our independence.

Summary of non-audit work		
Description of non-audit service	**Fee**	**Potential threat to auditor independence and associated safeguards in place**
Traded Services and Commercialisation	£50,000	**Self-interest**: This engagement is entirely separate from the audit through a separate contract, engagement team and lead partner. Therefore, the proposed engagement will have no perceived or actual impact on the audit team and the audit team resources that will be deployed to perform a robust and thorough audit. **Self-review:** The nature of this work is to review the assumptions and conclusions reached and to provide insight into areas where issues have not been considered. Therefore, it does not impact on our opinion and we do not consider that the outcome of this work will be a threat to our role as external auditors. The existence of a separate team for this work is a further safeguard. Consequently, we consider we have appropriately managed this threat. **Management threat:** This work will be advice and support only – all decisions will be made by the Authority. **Familiarity**: This threat is limited given the scale, nature and timing of the work. The existence of the separate team for this work is the key safeguard. **Advocacy**: We will not act as advocates for the Authority in any aspect of this work. We will draw on our experience in such roles to provide the Trust with a range of approaches but the scope of this work falls well short of any advocacy role. **Intimidation**: not applicable
Leeds City Council Investment Packaging Study	£25,000	**Self-interest**: This engagement is entirely separate from the audit through a separate contract, engagement team and lead partner. Therefore, the proposed engagement will have no perceived or actual impact on the audit team and the audit team resources that will be deployed to perform a robust and thorough audit. **Self-review:** The nature of this work is to review the assumptions and conclusions reached and to provide insight into areas where issues have not been considered. Therefore, it does not impact on our opinion and we do not consider that the outcome of this work will be a threat to our role as external auditors. The existence of a separate team for this work is a further safeguard. Consequently, we consider we have appropriately managed this threat. **Management threat:** This work will be advice and support only – all decisions will be made by the Authority. **Familiarity**: This threat is limited given the scale, nature and timing of the work. The existence of the separate team for this work is the key safeguard. **Advocacy**: We will not act as advocates for the Authority in any aspect of this work. We will draw on our experience in such roles to provide the Trust with a range of approaches but the scope of this work falls well short of any advocacy role. **Intimidation**: not applicable
Total fees	**£75,000**	
Total fees as a percentage of the external audit fees	**32%**	

**exclusive of VAT*

All non-audit work listed above has been approved by the PSAA. No other non-audit work has taken place in year.

Appendix 6

Audit fees

Audit fees

As communicated to you in our External Audit Plan 2016/17, our scale fee for the audit is £231,953 plus VAT in 2016/17, which is the same as the prior year.

Our work on the certification of Housing Benefits (BEN01) is planned for September 2017. The planned scale fee for this is £17,721 plus VAT. There are no other planned fees for other grants and claims.

PSAA fee table		
Component of audit	**2016/17** *(planned fee)* *£*	**2015/16** *(actual fee)* *£*
Accounts opinion and use of resources work		
PSAA scale fee set in [2014/15]	231,953	231,953
Subtotal	**231,953**	**231,953**
Housing benefits (BEN01) certification work		
PSAA scale fee set in [2014/15]	17,721	15,923
Total fee for the Authority set by the PSAA	**249,674**	**247,876**

All fees are quoted exclusive of VAT.