KPMG
cutting through complexity

Report to those charged with governance (ISA 260) 2014/15

Leeds City Council

September 2015

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Contents

The contacts at KPMG in connection with this report are:

Trevor Rees

Partner

KPMG LLP (UK)

Tel: +44 161 2464063
trevor.rees@kpmg.co.uk

Rob Walker
Manager
KPMG LLP (UK)

Tel: +44 113 2313619
Rob.Walker@KPMG.co.uk

Charlotte George
Assistant Manager
KPMG LLP (UK)

Tel: +44 113 2542836
Charlotte.George@KPMG.co.uk

This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

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 Trevor Rees, the engagement lead to the Authority, and the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, who will try to resolve your complaint. 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 3HZ.

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Section one
Introduction

This document summarises:

- **the key issues identified during our audit of the financial statements for the year ended 31 March 2015 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 2014/15 financial statements; and
- the work to support our 2014/15 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 2014/15*, presented to you in December 2014, set out the four stages of our financial statements audit process.

We previously reported on our work on the first two stages in our *Interim Audit Report /Letter 2014/15* issued in June 2015.

This report focuses on the third stage of the process: substantive procedures. Our on site work for this took place during July and August 2015.

It also includes any additional findings in respect of our control evaluation which we have identified since we issued our *Interim Audit Report/Letter 2014/15*.

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 2014/15* explained our risk-based approach to VFM work. We have now completed the work to support our 2014/15 VFM conclusion. This included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion;
- considering the results of any relevant work by the Authority and other inspectorates and review agencies in relation to these risk areas; and
- carrying out additional risk-based work.

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 2014/15 financial statements of the Authority.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1.

Acknowledgements

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

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Headlines

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

Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2015. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.
Audit adjustments	We are pleased to report there are no unadjusted audit misstatements.
Key financial statements audit risks	We review risks to the financial statements on an ongoing basis. We identified the following key financial statements audit risk in our 14/15 External audit plan issued in December 2014. ▪ The valuation of property, plant and equipment. We have worked with officers throughout the year to discuss this key risk and our detail findings are reported in section 3 of this report. There are no matters of any significance arising as a result of our audit work in these key risk areas.

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Headlines

Accounts production and audit process	The draft financial statements were produced by the 30 June deadline, and officers dealt with audit queries in a timely manner. In general, we have noted an improvement in the quality of the accounts and the supporting working papers, although there were still some occasions where we had to delay carrying out the work on a particular area because working papers were not ready, for example valuation reports for Property, Plant and Equipment, and a data request relating to Staff Expenses. At the same time we recognise that the timeliness of requests made by audit for information also needs to be improved, for example requesting journals evidence. The Authority has implemented the recommendations in our *ISA 260 Report 2013/14* relating to the financial statements. As noted above there are still improvements to be made in the production of working papers and requests made of the Authority by audit for information.
Completion	At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas: ■ Review of the letter of assurance from the West Yorkshire Pension Fund auditors Mazars; ■ Carrying out final checks on the financial statements; and ■ Review of possible post-balance sheet events, in particular around potential contingent liabilities and provisions. Before we can issue our opinion we require a signed management representation letter. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.
VFM conclusion and risk areas	We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2015.

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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.

We anticipate issuing an unqualified audit opinion in relation to the Authority's financial statements by 30 September 2015.

The wording of your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007

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 Audit Committee on 18 September 2015.

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 (see Appendix 3 for more information on materiality) level for this year's audit was set at £29.25 million. Audit differences below £1.95 million are not considered significant.

We did not identify any material misstatements. We identified a number of issues that had already been adjusted by management

Of the audit adjustments identified, the most significant in monetary value is as follows:

- £10.9 million reduction of the opening net book value of Property Plant and Equipment following the review of whether each school should be held on or off balance sheet.

In addition, we identified a small number of presentational adjustments, which the Authority will be addressing.

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.

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Financial Statements (continued)
Significant risks and key areas of audit focus

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 2014/15*, presented to you in December 2014, we identified the significant risks affecting the Authority's 2014/15 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

The table below sets out our detailed findings for each of the risks that are specific to the Authority.

Significant audit risk	Issue	Findings
Valuation of Property, Plant and Equipment	In 2013/14 late changes were made to the asset valuations in the financial statements after the accounts were sent for audit, mainly to incorporate PPE revaluations not available in time for the first draft. No late changes were made in 2014/15 however there is a significant element of judgement required in valuation, the total impact of the changes was in the 2014/15 financial statements was £150m.	Our work in 2014/15 involved sample testing assets revalued in year to confirm the asset register values reflected the latest valuation certificate. We agreed the PPE disclosure note to the asset register to ensure the completeness of the financial statements. We also assessed the reliability of the in-house valuer as management's expert and concluded we could rely on their work. We concluded that the property, plant and equipment balance is not materially misstated.

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Financial Statements (continued)
Significant risks and key areas of audit focus (continued)

In our *External Audit Plan 2014/15* 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.

Areas of significant risk		Summary of findings
Management override of controls	Audit areas affected ■ All areas	Our audit methodology incorporates the risk of management override as a default significant risk. 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. 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.
Fraud risk of revenue recognition	Audit areas affected ■ None	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 2014/15 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.

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Financial Statements (continued)
Significant risks and key areas of audit focus (continued)

In our *External Audit Plan 2014/15*, presented to you in December 2014, we identified one area of audit focus. This is not considered as a significant risk but area 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 this area of audit focus.

Areas of audit focus	Issue	Findings
Pensions	Valuation of assets supporting the pension fund have fluctuated significantly over recent years. In 2013/14 the Authority's share of the Local Government Pension Scheme liability was £818m at 31 March 2014, a reduction of £368m from the previous year. The valuation is determined by the scheme's actuary, based on several key assumptions which are judgemental in nature.	We reviewed the accounts disclosures to the Authority's IAS19 report. We reviewed the key inputs to the valuation, including the information supplied by the Authority to the actuary, including the contributions figures. We assessed the reasonableness of the assumptions used in the calculation and the scheme's actuary AON Hewitt's qualifications as management's expert. We concluded the estimation of the liability was reasonable.

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Financial Statements (continued)
Accounts production and audit process

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

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

The Authority has implemented the recommendations in our *ISA 260 Report 2013/14.*

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 continues to maintain a strong financial reporting process and produce statements of accounts to a good standard. We consider that accounting practices are appropriate
Completeness of draft accounts	We received a complete set of draft accounts on 30 June.
Quality and timeliness of supporting working papers	Our *Accounts Audit Protocol*, which we issued in February 2015 and discussed with the Principal Financial Manager, set out our working paper requirements for the audit. The quality of working papers provided was variable but met the standards specified in our *Accounts Audit Protocol*. There still remains scope to improve the timeliness of working papers by providing these in advance of when we plan to start the task per our work plan. We will follow this up in our audit debrief with the Authority. This did not have a significant impact on our progress, as we were able to work around this by bringing forward other audit work.
Response to audit queries	Officers resolved the majority of audit queries in a reasonable time. In some cases, however, we experienced delays, specifically where staff who originally prepared the working papers were not available.

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

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

We reported in our *Interim Audit Report 2014/15* that we were yet to complete our testing of controls operated during the closedown process.

We have now concluded our testing on this area, and consider whilst there are some improvements to be made, overall the organisational, IT and key financial systems controls to be sound. We have raised a recommendation in respect of the Authority's controls in Appendix 1.

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 the recommendations in our *ISA 260 Report 2013/14*. As detailed above, there is still progress to be made in respect to the timeliness of the Authority's working papers and requests made by audit.

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Financial Statements (continued) 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 2015, 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 2 in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template 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 others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority's 2014/15 financial statements.

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VFM conclusion

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

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

Background

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

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

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

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

Work completed

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

We identified one focus area in our External Audit Plan 2014/15, on the Authority's savings plan, which we have monitored throughout the year. We have included an update on this on the next page.

Conclusion

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

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

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Specific VFM risks

We have identified one specific financial resilience risk in respect of our VFM responsibilities

We are satisfied that the Authority's has adequate arrangements to address this risk

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
- reviewed the level of reserves, and medium term financial plan to maintain a balanced financial position.

Key findings

Below we set out the findings in respect of the focus area as set out in our *External Audit Plan* identifying a key risk relating to the level of usable reserves maintained by the Authority. Whilst the level of general reserves is higher than planned the significant increase in the collection fund deficit is a concern. The Authority has plans in place to address these issues in future financial plans. With further planned cuts in central government funding the future financial position of the Authority will remain tight with minimal flexibility to deal with any unexpected overspending budgets.

Overall we concluded there is evidence that the Authority has arrangements to secure financial resilience, looking at the Authority's financial governance, financial planning and financial control processes.

Key VFM Risk	Risk description and link to VFM conclusion	Assessment
Reserves **Audit areas affected** - Reserves and balances	In the audit plan we identified the delivery of the savings programme as an area of audit focus. We planned to review the level of potential liabilities arising from the early leavers scheme but these were not material and there was no evidence of significant issues facing the Authority in this respect. The Authority also achieved its main savings targets delivering a £0.7m underspending. Considering the financial resilience of the Authority and the significant increase in the level of collection fund reserve deficit from £5.2m to £27.6m we concluded this was a significant risk: We assessed: - the level of reserves available at 31st March 2015 against the Authority's reserves policy; and. - the assumptions made in the medium term financial plan.	General and usable reserves are a key measure of the financial resilience allowing the Authority to address unexpected overspendings or loss of income. During the year the level of general reserves reduced from £26.0m to £22.3m £0.4m higher than planned. The overall financial position however, worsened significantly towards the end of the financial year. During the year 5,843 business rate appeals were received, 4,265 in March 2015 alone, significantly increasing the collection fund deficit from £5.2m to £27.6m based on an estimate of the success of the appeals. Before these extra appeals the Authority already planned to reduce general reserves to £20.9m by the end of March 2016 reducing the Authority's resilience to deal with any major service overspendings or under recovery of income in future Despite this difficult financial position overall assumptions made in the medium term plan appear reasonable in respect of income, expenditure, inflation and commitments and hence there is evidence that the Authority has arrangements to secure financial resilience.

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Appendix 1: Key issues and recommendations

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

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

We will formally follow up these recommendations next year.

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

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
1	❸	**Availability of Working Papers** 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. **Recommendation** Working papers should be available in advance of the date we plan to start the work as set out in the work plan. We propose to have further discussions with the Authority in our audit debrief as to how to achieve this.	**Management response** The council's accounts team will continue to work with KPMG to agree in advance the timing and content of audit working papers, to ensure that the process is as efficient as possible for both parties. **Responsible officer** Principal Financial Manager (Corporate Financial Management) **Due date** 2015/16 accounts process.

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Appendix 1: Key issues and recommendations (continued)

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
2	3	**3 Way Matching of Invoice types IN and IS** 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. **Recommendation** 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.	**Management response** Procedures in place at the Business Support Centre already identify some specific areas where an FMS order is not expected. In March 2015 the authority commenced an exercise to review this, to clarify whether there are further areas of spend which would routinely not require an order in FMS. Any option to introduce a system development to allow such invoices to be identified by a marker in the FMS system would be subject to a cost-benefit analysis. **Responsible officer** Head of Financial Services (Business Support Centre) **Due date** March 2016

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Appendix 1: Key issues and recommendations (continued)

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
3	❸	**Access to Approve Purchase Orders on FMS** We identified issues with access rights to approve purchase orders on FMS during the course of our audit. These issues fell into three categories: • 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. • 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. • 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. **Recommendations** Timescales should be set for implementing the decision to remove service user functions for finance officers. 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. Any future automated implementation of standardised access rights should be reviewed carefully to ensure it is appropriate for all groups of users on FMS.	**Management response** 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 **Responsible officer** Principal Financial Manager (Corporate Financial Management) **Due date** September 2015

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Appendix 2: Declaration of independence and objectivity

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

Requirements

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

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

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the 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 Corporate Governance and Audit Committee.

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

General procedures to safeguard independence and objectivity

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

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Appendix 2: Declaration of independence and objectivity (continued)

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

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

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

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

Auditor declaration

In relation to the audit of the financial statements of Leeds City Council for the financial year ending 31 March 2015, 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.

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Appendix 3: Materiality and reporting of audit differences

For 2014/15 our materiality is £29.25 million for the Authority's accounts.

We have reported all audit differences over £29.25 million for the Authority's accounts to the Audit Committee.

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.

Materiality for the Authority's accounts was set at £29.25m which equates to around 1.5 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Corporate Governance and 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 Corporate Governance and 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 £1.95m 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 Corporate Governance and Audit Committee to assist it in fulfilling its governance responsibilities.

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Appendix 4: KPMG Audit Quality Framework

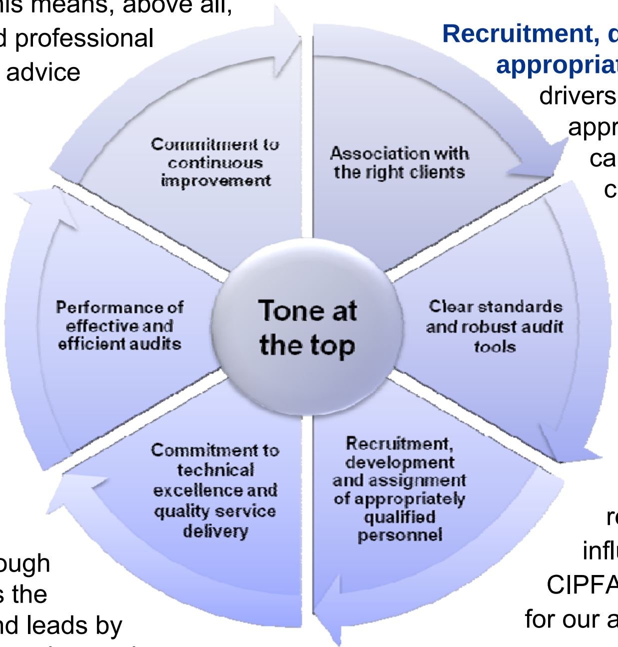
We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG.

The diagram summarises our approach and each level is expanded upon.

At KPMG we consider audit quality is not just about reaching the right opinion, but how we reach that opinion. KPMG views the outcome of a quality audit as the delivery of an appropriate and independent opinion in compliance with the auditing standards. It is about the processes, thought and integrity behind the audit report. This means, above all, being independent, compliant with our legal and professional requirements, and offering insight and impartial advice to you, our client.



KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG. We use our seven drivers of audit quality to articulate what audit quality means to KPMG.

We believe it is important to be transparent about the processes that sit behind a KPMG audit report, so you can have absolute confidence in us and in the quality of our audit.

Tone at the top: We make it clear that audit quality is part of our culture and values and therefore non-negotiable. Tone at the top is the umbrella that covers all the drives of quality through a focused and consistent voice. Trevor Rees as the Engagement Lead sets the tone on the audit and leads by example with a clearly articulated audit strategy and commits a significant proportion of his time throughout the audit directing and supporting the team.

Association with right clients: We undertake rigorous client and engagement acceptance and continuance procedures which are vital to the ability of KPMG to provide high-quality professional services to our clients.

Clear standards and robust audit tools: We expect our audit professionals to adhere to the clear standards we set and we provide a range of tools to support them in meeting these expectations. The global rollout of KPMG's eAudIT application has significantly enhanced existing audit functionality. eAudIT enables KPMG to deliver a highly technically enabled audit. All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's *Code of Audit Practice*.

Recruitment, development and assignment of appropriately qualified personnel: One of the key drivers of audit quality is assigning professionals appropriate to the Authority's risks. We take great care to assign the right people to the right clients based on a number of factors including their skill set, capacity and relevant experience.

We have a well developed technical infrastructure across the firm that puts us in a strong position to deal with any emerging issues. This includes:

- A national public sector technical director who has responsibility for co-ordinating our response to emerging accounting issues, influencing accounting bodies (such as CIPFA) as well as acting as a sounding board for our auditors.

- A national technical network of public sector audit professionals is established that meets on a monthly basis and is chaired by our national technical director.

- All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's *Code of Audit Practice*.

- A dedicated Department of Professional Practice comprised of over 100 staff that provide support to our audit teams and deliver our web-based quarterly technical training.

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Appendix 4: KPMG Audit Quality Framework

We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

Quality must build on the foundations of well trained staff and a robust methodology.

Commitment to technical excellence and quality service delivery: Our professionals bring you up- the-minute and accurate technical solutions and together with our specialists are capable of solving complex audit issues and delivering valued insights.

Our audit team draws upon specialist resources including Forensic, Corporate Finance, Transaction Services, Advisory, Taxation, Actuarial and IT. We promote technical excellence and quality service delivery through training and accreditation, developing business understanding and sector knowledge, investment in technical support, development of specialist networks and effective consultation processes.

Performance of effective and efficient audits: We understand that how an audit is conducted is as important as the final result. Our drivers of audit quality maximise the performance of the engagement team during the conduct of every audit. We expect our people to demonstrate certain key behaviors in the performance of effective and efficient audits. The key behaviors that our auditors apply throughout the audit process to deliver effective and efficient audits are outlined below:

- timely Engagement Lead and manager involvement;
- critical assessment of audit evidence;
- exercise of professional judgment and professional scepticism;
- ongoing mentoring and on the job coaching, supervision and review;
- appropriately supported and documented conclusions;
- if relevant, appropriate involvement of the Engagement Quality Control reviewer (EQC review);
- clear reporting of significant findings;
- insightful, open and honest two-way communication with those charged with governance; and
- client confidentiality, information security and data privacy.

Commitment to continuous improvement: We employ a broad range of mechanisms to monitor our performance, respond to feedback and understand our opportunities for improvement.

Our quality review results

Public Sector Audit Appointments Ltd publishes information on the quality of work provided by us (and all other firms) for audits undertaken on behalf of them (http://www.psaa.co.uk/audit-quality/principal-audits/kpmg-audit-quality/).

The latest Annual Regulatory Compliance and Quality Report (issued June 2015) showed that we are meeting the overall audit quality and regulatory compliance requirements.

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cutting through complexity™

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