Appendix2

GOVERNMENT

Report to those charged with governance (ISA 260) 2009/10

Leeds City Council

September 2010

AUDIT

AUDIT ▪ TAX ▪ ADVISORY

Contents

The contacts at KPMG in connection with this report are:

Mike McDonagh

Partner
KPMG LLP (UK)
Tel: 0121 335 2440
michael.a.mcdonagh@kpmg.co.uk

Steve Clark

Director
KPMG LLP (UK)
Tel: 0113 254 2910
stephen.clark@kpmg.co.uk

Jillian Burrows

Senior Manager
KPMG LLP (UK)
Tel: 0161 246 4705
jillian.burrows@kpmg.co.uk

Alison Ormston

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

Sam Bradford

Assistant Manager
KPMG LLP (UK)
Tel: 0113 231 3624
sam.bradford@kpmg.co.uk

Report Sections		Page
Section One	Executive Summary	2
Section Two	Financial statements	4
Section Three	Use of resources	13

Appendices		Page
Appendix A	Proposed opinion on the financial statements	14
Appendix B	Proposed value for money conclusion	16
Appendix C	Recommendations	17
Appendix D	Audit differences	19
Appendix E	Declaration of independence and objectivity	20
Appendix F	Draft management representation letter	23

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 has issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document.

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.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Mike McDonagh, who is the engagement partner to the Authority (telephone 0121 335 2440, email michael.a.mcdonagh@kpmg.co.uk) who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees (0161 236 4000, email trevor.rees@kpmg.co.uk) who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Investigation Officer, Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR or by email to complaints@audit-commission.gov.uk. Their telephone number is 0844 798 3131, textphone (minicom) 020 7630 0421.

Executive summary

Scope of this report

This report summarises:

- the key issues identified during our audit of Leeds City Council's ('the Authority's) financial statements for the year ended 31 March 2010; and
- our assessment of the Authority's arrangements to secure value for money in its use of resources.

This report does not repeat matters we have previously communicated to you. In particular, we draw your attention to our Interim Audit Report 2009/10, presented to you on 23 June, which summarised our planning and interim audit work

Financial Statements

The table below summarises the key findings from our work to date in relation to the financial statements audit. Section two of this document provides further details.

Proposed opinion	We anticipate issuing an unqualified audit opinion on 29 September 2010. We will also report that the wording of your Annual Governance Statement accords with our understanding.
Accounts production and audit process	We have noted an overall improvement in the quality of the accounts and the supporting working papers. In particular, the quality of the working papers for the new PFI accounting requirements were excellent. This is an extremely complex area and finance staff should be commended for the way in which this has been dealt with. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales. The Authority has implemented the recommendations in our ISA 260 Report 2008/09 relating to the financial statements.
Critical accounting matters	We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.
Audit differences	Our audit identified two significant audit adjustments with a total value of £4,342k. The impact of these adjustment is to increase the value of fixed assets by £1,942k with a similar adjustment being made to the revaluation reserve and capital adjustment account. We have also made an adjustment as part of our review of the PFI entries made for 2008-09. This was for £2,400k and was a movement within the I&E account. These adjustments have been made by the Authority and are included in Appendix D. There have been a number of other adjustments which have been made by the Authority as a result of their own Quality Assurance and review processes. The most significant movements include a revision of the pension entries (£115m on the I&E) and some movements between headings on the I&E account (from central services to Children's and exceptional items) total value circa £9m. None of these changes affect the movement on General Fund Balance for the year. The Authority also identified five assets which were to be revalued in year which turned out to be no-longer owned, despite these being on the fixed asset register. In addition the Authority also found one further asset which had been duplicated incorrectly on the asset register The value of these six properties was £3.2m We have recommended a number of small presentational amendments to the financial statements to management, these have all been adjusted for. We have raised a number of recommendations in relation to the matters highlighted here and other issues arsing during this audit, which are summarised in Appendix C.
Completion	At the date of this report our audit of the financial statements is nearly complete. 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.

Executive summary

Use of Resources

The table below summarises the key findings from our assessment of the Authority's arrangements to secure value for money in its use of resources.

Our findings are detailed in section three of this report.

Proposed opinion	We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.
Use of resources assessment	Following the change in government, the use of resources assessment at local authorities ceased with immediate effect in May 2010. The Authority will therefore not receive scores in respect of the 2010 assessment. Overall the Authority had maintained its performance across the UOR themes with improvements being made where our 2009 assessment flagged areas for development. In addition, we reviewed the workforce planning arrangements in place at the Authority for the first time. We found that the Authority had sound arrangements in place in this area. Given the Government's plan to reduce spending it is expected that the focus of our work in future years will be around financial resilience.
Specific use of resources risks	We have considered the specific use of resources risks around how the Authority responded to the recession and the sustainability agenda as set out in our Audit Fee Letter 2009/10. This has been used to inform our VFM opinion.

Exercise of other powers

We have a duty under section 8 of the Audit Commission Act 1998 to consider whether, in the public interest, to report on any matter that comes to our attention in order for it to be brought to the attention of the public. In addition we have a range of other powers under the 1988 Act.

No issues have arisen that have required us to issue a report in the public interest.

Certificate

We are required to certify that we have completed the audit in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice. If there are any circumstances under which we cannot issue a certificate, then we are required to report them to you and to issue a draft opinion on the financial statements.

At present there are no issues that would cause us to delay the issue of our certificate of completion of the audit.

Acknowledgements

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

Introduction

We have completed our work on the 2009/10 financial statements.

We anticipate issuing an unqualified audit opinion on 29 September 2010.

The Authority's and our responsibilities

Leeds City Council is responsible for having effective systems of internal control to ensure the regularity and lawfulness of transactions, to maintain proper accounting records and to prepare financial statements that give a true and fair view of its financial position and its expenditure and income. It is also responsible for preparing and publishing an Annual Statement of Governance with its financial statements.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

The Audit Commission's Code of Audit Practice requires us to summarise the work we have carried out to discharge our statutory audit responsibilities together with any governance issues identified and we report to those charged with governance (in this case the Corporate Governance and Audit Committee) at the time they are considering the financial statements.

We are also required to comply with International Standard on Auditing (ISA) 260 which sets out our responsibilities for communicating with those charged with governance.

This report meets both these requirements.

Introduction

Our audit of the financial statements can be split into four phases:

Planning → Control Evaluation → Substantive Procedures → Completion

We previously reported on our work on the first two stages in our *Interim Audit Report 2009/10* issued in June 2010.

This report focuses on the final two stages: substantive procedures and completion. It also includes any additional findings in respect of our control evaluation that have been identified since we issued our *Interim Audit Report 2009/10*.

Substantive Procedures

Our final accounts visit on site took place between 12 July and 13 September. During these 9 weeks, we carried out the following work:

Substantive Procedures

- Planning and performing substantive audit procedures
- Concluding on critical accounting matters
- Identifying audit adjustments
- Reviewing the Annual Governance Statement

We have completed our audit of the Authority's 2009/10 financial statements.

Completion

We are now in the final phase of the audit. Some aspects are discharged through this report:

Completion

- Declaring our independence and objectivity
- Obtaining management representations
- Reporting matters of governance interest
- Forming our audit opinion

We anticipate issuing an unqualified audit opinion on 29 September 2010.

Accounts production and audit process

We have noted a continued improvement in the quality of the accounts and the supporting working papers.

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

The Authority has implemented the recommendations in our *ISA 260 Report 2008/09* relating to the financial statements.

The wording of your Annual Governance Statement accords with our understanding.

Accounts production and audit process

ISA 260 requires us to communicate to you our views about the qualitative aspects of the Authority's accounting practices and financial reporting.

We also assessed the Authority's process for preparing the accounts and its support for an efficient audit.

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority has strong financial reporting processes and quality checks in place to assist in the preparation of the financial statements. We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 30 June. This was taken to the Corporate Governance and Audit Committee. The Authority has made a number of adjustments to the accounts since this date along with two audit adjustments and a small number of presentational adjustments. The audit adjustment is shown in appendix D.
Quality of supporting working papers	Our accounts protocol which was sent to the Principal Accountant set out our working paper requirements for the audit. The quality of working papers provided met the standards specified in our Accounts Audit Protocol. We would particularly like to highlight the exemplary quality of the PFI working papers and models.
Response to audit queries	The majority of additional audit queries were resolved in a reasonable time.

Prior year recommendations

In our *Interim Audit Report 2009/10* we commented on the Authority's progress in addressing the recommendations in our *ISA 260 Report 2008/09*.

The Authority has implemented all of the recommendations in our *ISA 260 Report* 2008/09 relating to the financial statements.

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 in June 2007; and
- it is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

Critical accounting matters

We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed these issues appropriately.

However we have found further issues this year with fixed asset accounting.

Work completed

- In our *Financial Statements Audit Plan 2009/10*, presented to on 23 June 2010, we identified the key risks affecting the Authority's 2009/10 financial statements.
- In our *Interim Audit Report 2009/10* we commented on the Authority's progress in addressing these key risks.
- We have now completed our testing of these areas and set out our final evaluation following our substantive work.
- The table below sets out our detailed findings for each risk.

Key audit risk	Issue	Findings
Private Finance Initiative - IFRS	All local authority accounts will be based on International Financial Reporting Standards (IFRS) from 2010/11. As part of the transition process, the revised accounting requirements for Private Finance Initiative (PFI) schemes are applied early under the 2009 Code of Practice on Local Authority Accounting in the United Kingdom: A Statement of Recommended Practice (SORP), to the 2009/10 financial statements. This is a technically complex change and may result in some assets being accounted for in the Authority's balance sheet that previously were not. The Authority has seven operational PFI contracts. They will need to re-evaluate these contracts under IFRS and potentially model the payments over the contract life to calculate the assets and liabilities to be accounted for. In addition, officers are considering the likelihood for two new PFI schemes to be approved which will also need to be assessed under the new accounting requirements.	We have had regular discussions with management throughout the year which has enabled us to review the progress being made by the Authority. The Authority has now completed its re-statement of their PFI schemes under the new International Financial Reporting Standards (IFRS) . The Authority evaluated all its PFI contracts against the requirements and this resulted in all seven PFIs now being accounted for on the Balance Sheet. The Authority has compiled its own models for all contracts and we have audited this in year. We have found the models to be well put together by Authority staff and have not found any issues with these.

Critical accounting matters (continued)

Key audit risk	Issue	Findings
Fixed Asset Valuation	During our 2008/09 audit we identified three audit adjustments relating to fixed asset balances. Two of these adjustments related to the fact that the non-enhancing spend write off in year had not been reviewed as part of the accounts closedown quality assurance process. The third fixed asset adjustment related to the fact that the revaluation of three fixed assets completed in year had not been picked up by the accounts team. The Authority need to ensure that they complete a detailed quality assurance review of their accounts closedown process to prevent similar issues arising in year and to ensure that the valuation of its asset base is not materially misstated.	This year we have again found a small number of errors relating to fixed asset valuations. We found five assets which were to be revalued in year which then revealed that the authority no-longer owned these assets despite them being on the fixed asset register. We also found one further asset which had been revalued in the year which revealed that this asset was on the asset register twice. The value of these six properties was £3.2m and this has been adjusted for in the accounts. This has not been deemed an audit adjustment as it was identified by the Council but is mentioned here as it affects our view of the control environment. In addition to this we found five assets which had been under construction which were then revalued but these values were not updated in the fixed asset register. This resulted in the fixed assets of the Authority being under-valued by £1.942m this adjustment has now been made by the Authority.

Critical accounting matters (continued)

Key audit risk	Issue	Findings
Local Taxes/ Rent Arrears	In addition to the changes to the accounting for PFI schemes, the 2009 SORP introduces a number of other changes, which take effect in 2009/10, including: Changes to the accounting treatment for Business Rates (NNDR) and Council Tax in England; and Changes to disclosure requirements which includes: – Officers remuneration disclosure now referring to "applicable regulations"; and – Five disclosure notes being removed. The Authority need to review and appropriately address these changes in the 2009/10 financial statements.	We have discussed these issues with management at an early stage to clarify points of uncertainty when interpreting the SORP guidance. We have now audited the NNDR and Council Tax and income and arrears balances included in the financial statements and are satisfied that they have been prepared in accordance with the requirements of the 2009/10 SORP. In addition, the Authority has appropriately prepared the prior period adjustment required to reflect the changes in accounting policy. We have also reviewed the other key changes in the SORP and are satisfied that these have been correctly disclosed by the Authority.
SORP Changes	The Authority have experienced there is difficultly in the ability of local residents / businesses to meet their financial commitments given the economic downturn. The Authority will need to ensure that they have reflected this within their provision levels for Council Tax, National Non Domestic Rates and Rents due. The Authority will need to review their collections rates for Council Tax, National Non Domestic Rates and Rents due to ensure that they have appropriately provided for any amounts that may not be collectable in the current economic climate.	Again, we have discussed these issues with management at an early stage to clarify points of uncertainty and have reviewed the bad debt provision used by the authority and the benefits provision. We are satisfied that the Authority has appropriately provided for any amounts that may not be collectable in the current economic climate.

Critical accounting matters (continued)

Key audit risk	Issue	Findings
Loan Valuations	Due to the economic downturn there has also been a reduction in the ability of organisations / companies to meet their financial commitments. As a consequence the Authority will need to ensure that the full value of any loans they may have issued are fully recoverable. Where the Authority have revised the terms of any loans issued, they need to ensure that the full value of these loans are recoverable and that any loans at less that commercial interest rates are appropriately accounted for within the financial statements.	During the year we have met with officers at the Authority to discuss the Authority's loans to third parties. In addition, we have reviewed the assumptions used and proposed accounting treatment to ensure it is in line with CIPFA requirements during our final audit visit. We are satisfied that these loans are appropriately accounted for within the financial statements.

Audit commentary – pension liabilities

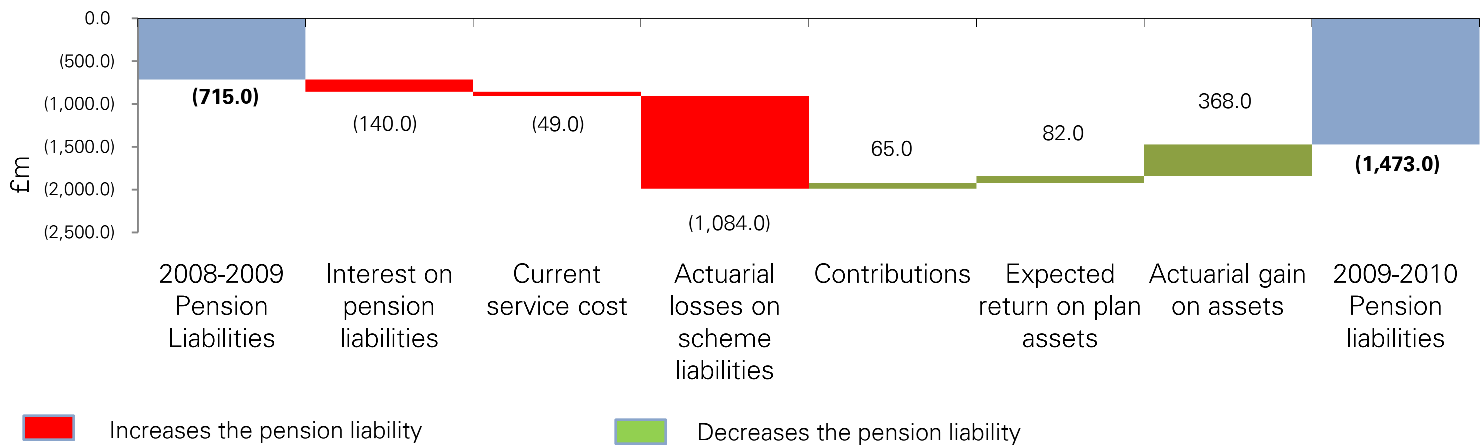
There were significant movements in the Authority's net pension liabilities. This was largely due to a change in assumptions used by the actuary to estimate the liabilities and also the performance of the capital markets affecting the pension assets.

In addition, following the balance sheet date the Government announced a change to the way pensions are to be linked to a different inflationary measure. This has resulted in a requirement for authorities to disclose a post balance sheet event disclosure.

Members will have noticed that there has been a significant increase in the pension liabilities disclosed in the Authority's balance sheet from 2008/09 to 2009/10. This is consistent with other pension funds around the country.

Below we have provided an analysis of the pension liability movement to aid Members' understanding of the reasons for this.

From this analysis it can be seen that the largest change in the pension liability is due to the actuarial losses on the pension scheme. There was an actuarial loss on the liabilities of £1,084 million, which was partially offset by a gain of £368 million on the pension assets. The fundamental reason for the change is due to the AA corporate bond discount rate which all Local Authorities have had to use. In addition there has been a change in the assumptions used by the actuary to estimate the pension fund liabilities which has resulted in increases in life expectancy for example. These estimates are within reasonable expectations and consistent with other Local Authorities in the West Yorkshire region.



Government announcement on pension increases

The Government has, however, recently announced that the basis upon which pensions increase will, in the future, be based on the Consumer Price Index (CPI) as opposed to the Retail Price Index (RPI). As CPI is typically lower than RPI, this is expected to have a positive impact upon pension scheme liabilities

As a result of this announcement, the Authority has disclosed a post balance sheet event in its notes to the financial statements and quantified the level of change on using the advice of it's actuaries. This is considered to be a 'non-adjusting event' under the relevant financial reporting standard (FRS 21). This means that the balance sheet for 2009/10 has not been changed to reflect this announcement as the announcement was made after the balance sheet date.

Audit differences

Our audit identified a total of 2 audit adjustments with a total value of £4.342m

The impact of these adjustments is to:

- **Increase/the net worth of the Authority as at 31 March 2010 by £1.942m; and**
- **Result in a movement of £2,400k within the I&E account for the adjustment made to the 2008-09 PFI entries.**

Work completed

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.

Key findings

Our audit identified a total of two audit adjustments with a total value of £4.342m. The net impact on the General Fund as a result is to increase the fixed asset balance as at 31 March 2010 by £1.942m and also result in a movement of £2,400k within the I&E account for the 2008-09 PFI entries.

We have provided a summary of these audit differences in Appendix D. It is our understanding that these will be adjusted in the final version of the financial statements.

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 the United Kingdom 2009: A Statement of Recommended Practice* ('SORP'). We understand that the Authority will be addressing these where significant.

The Authority also identified five assets which were to be revalued in year which turned out to be no-longer owned, despite these being on the fixed asset register. In addition the Authority also found one further asset which had been duplicated incorrectly on the asset register The value of these six properties was £3.2m

There have been a number of other adjustments which have been made by the Authority as a result of their own Quality Assurance and review processes. The significant movements include a revision of the pension entries (£115m on the I&E) and some movements between headings on the I&E account (from central services to Children's and exceptional items) total value circa £9m. None of these changes affect the movement on General Fund Balance for the year. These changes were necessary due to some miscoding of expenditure between services and also a mistake in posting the double entry for the pension costs. The Authority has also made a number of changes to the accounts figures which we believe to be trivial and as such have not reported this here.

The tables below illustrates the total impact of audit differences on the Authority's income and expenditure account for the year and balance sheet as at 31 March 2010.

Income & expenditure 2009/10	Pre-audit £m	Post-audit £m
Net cost of services	791,308	674,647
Other operating income & expenditure	(594,121)	(477,460)
Surplus/ deficit for the year	**197,187**	**197,187**
Net additional debits/ credits	(193,967)	(193,967)
Increase/ decrease in General Fund	**3,220**	**3,220**

Balance Sheet as at 31 March 2010	Pre-audit £m	Post-audit £m
Fixed assets	4,250,329	4,252,271
Other long term assets	53,574	53,574
Current assets	130,164	130,164
Current liabilities	(385,118)	(385,118)
Long term liabilities	(3,791,182)	(3,791,182)
Net worth	**257,767**	**259,709**
General Fund	(16,076)	(16,076)
Other reserves	(241,691)	(243,633)
Total reserves	**(257,767)**	**(259,709)**

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, and have provided a draft version at Appendix G.

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 2010, we confirm that there were no relationships between KPMG LLP and Leeds City Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix E 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 included a copy of a representation letter as Appendix F. We have provided a draft to the Director of Resources. We require a signed copy of your management representations before we issue our audit opinion.
We are seeking some specific representations in relation to the expenditure contained within the Housing Revenue Account (HRA)I, capitalised expenditure relating to Highways and the fact the Council has no liability in respect of the £10.5m grant from Yorkshire Forward for the East Leeds Link Road – these are detailed further in the letter at Appendix F.

Other matters

ISA 260 requires us to communicate "audit matters of governance interest that arise from the audit of the financial statements" to you which includes:

- material weaknesses in internal control identified during the audit;
- matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. issues relating to fraud, compliance with laws and regulations, subsequent events etc); and
- other audit matters of governance interest.

There are no others matters which we wish to draw to your attention.

Opinion

We anticipate issuing an unqualified audit opinion on 29 September 2010.

Our proposed opinion on the financial statements is presented in Appendix A

Introduction

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

The Authority's and our responsibilities

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources and regularly reviewing their adequacy and effectiveness.

We are required to conclude whether the Authority has adequate arrangements in place to ensure effective use of its resources. We refer to this as the 'value for money (VFM) conclusion'.

Introduction

Our assessment previously drew mainly on the findings from the use of resources assessment (UoR) framework, as the specified criteria for the VFM conclusion were the same as the UoR Key Lines of Enquiry (KLoE).

In May 2010 the new government announced that the Comprehensive Area Assessment (CAA) would be abolished. The Audit Commission subsequently confirmed that work related to CAA should cease with immediate effect. This includes work for UoR assessments at local authorities.

However, there is no change to the requirement in the statutory Code of Audit Practice for auditors to issue a VFM conclusion.

Findings from VFM work

At the time of the announcement, the vast majority of UoR work for 2010 had already been completed and this therefore informed our 2009/10 VFM conclusion.

We have provided feedback on the work undertaken to the Authority. The key message is that the Authority has met each of the VFM criteria, as can be seen from the table.

Going forward we expect that the focus of our work will be on financial resilience, given the anticipated cuts in Government spending. We will be undertaking a review of the Authority's Medium Term Financial Strategy (MTFS) in the coming months.

We also identified a number of specific risks impacting on our 2009/10 value for money conclusion. These included how the Authority responded to the recession and the sustainability agenda. We have held meetings and undertook targeted work on the responding to the recession risk. In addition, we have reviewed work undertaken by Internal Audit on the sustainability agenda.

Conclusion

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

Our proposed conclusion is set out in Appendix B.

VFM criterion	Met
Managing finances	
Financial planning	✓
Understanding costs and achieving efficiencies	✓
Financial reporting	✓
Governing the business	
Commissioning and procurement	✓
Data quality and use of information	✓
Governance	✓
Risk management and internal control	✓
Managing resources	
Use of natural resources	✓
Strategic asset management	✓
Workforce planning	✓

Appendix A: Proposed Opinion on the Financial Statements

Our opinion states whether the accounting statements and related notes give a true and fair view of the financial position of the Authority and its income and expenditure for the year.

We define what we mean by 'accounting statements'.

The audit report also includes our opinion on the Group accounts.

Independent auditors' report to the Members of Leeds City Council

Opinion on the accounting statements

We have audited the accounting statements and related notes of Leeds City Council for the year ended 31 March 2010 under the Audit Commission Act 1998. The accounting statements comprise the Income and Expenditure Account, the Statement of Movement on the General Fund Balance, the Statement of Total Recognised Gains and Losses the Balance Sheet, the Cash Flow Statement, the Housing Revenue Account Income and Expenditure Account, the Statement of Movement on the Housing Revenue Account Reserve and the Collection Fund. The accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to Leeds City Council, as a body, in accordance with Part II of the Audit Commission Act 1998. Our audit work has been undertaken so that we might state to Leeds City Council, as a body, those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than Leeds City Council, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Director of Resources and auditors

The Director of Resources responsibilities for preparing the financial statements in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009 are set out in the Statement of Responsibilities for the Statement of Accounts.

Our responsibility is to audit the accounting statements and related notes in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the accounting statements and related notes give a true and fair view, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009, of:

- the financial position of the Authority and its income and expenditure for the year; and
- the financial position of the Group and its income and expenditure for the year.

We review whether the governance statement reflects compliance with 'Delivering Good Governance in Local Government: A Framework' published by CIPFA/SOLACE in June 2007. We report if it does not comply with proper practices specified by CIPFA/SOLACE or if the statement is misleading or inconsistent with other information we are aware of from our audit of the financial statements. We are not required to consider, nor have we considered, whether the governance statement covers all risks and controls. Neither are we required to form an opinion on the effectiveness of the Authority's corporate governance procedures or its risk and control procedures.

Appendix A: Proposed Opinion on the Financial Statements (continued)

Our proposed opinion is unqualified.

There are no expected modifications to the auditors' report.

We read other information published with the accounting statements and related notes and consider whether it is consistent with the audited accounting statements and related notes. This other information comprises only the Explanatory Foreword. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounting statements and related notes. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with the Audit Commission Act 1998, the Code of Audit Practice issued by the Audit Commission and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounting statements and related notes. It also includes an assessment of the significant estimates and judgments made by the Authority in the preparation of the accounting statements and related notes, and of whether the accounting policies are appropriate to the Authority's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounting statements and related notes are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounting statements and related notes.

Opinion

In our opinion the accounting statements and related notes give a true and fair view, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009, of the financial position of the Authority and its Group as at 31 March 2010 and its income and expenditure for the year then ended.

Michael McDonagh (Senior Statutory Auditor) for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

One Snowhill
Snow Hill
Queensway
Birmingham
B4 6GH
29 September 2010

Appendix B: Proposed use of resources conclusion

Our proposed use of resources conclusion is unqualified.

Conclusion on arrangements for securing economy, efficiency and effectiveness in the use of resources

Authority's Responsibilities

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance and regularly to review the adequacy and effectiveness of these arrangements.

Auditors' Responsibilities

We are required by the Audit Commission Act 1998 to be satisfied that proper arrangements have been made by the Authority for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires us to report to you our conclusion in relation to proper arrangements, having regard to relevant criteria specified by the Audit Commission for principal local authorities. We report if significant matters have come to our attention which prevent us from concluding that the Authority has made such proper arrangements. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Conclusion

We have undertaken our audit in accordance with the Code of Audit Practice. Having regard to the criteria for principal local authorities specified by the Audit Commission and published in May 2008 and updated in February 2009, we are satisfied that, in all significant respects, Leeds City Council made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2010.

Michael McDonagh (Senior Statutory Auditor) for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

One Snowhill
Snow Hill
Queensway
Birmingham
B4 6GH
29 September 2010

Appendix C: Recommendations

We have identified 2 recommendations relating to Fixed Assets.

The detail is in the tables below

We have given each recommendation a risk rating (as explained below) and agreed what action management will need to take. We will follow up these recommendations next year.

Priority rating for recommendation		
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.	***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.	***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.	Priority	Issue & Recommendation	Management Response / Responsible Officer / Due Date
1	2	**Fixed Asset Disposals** Our review of Fixed Asset revaluations found there were six properties which were revalued in the year which were included on the fixed asset register which should not have been. Of these, five of the properties had been disposed of in prior years and one asset had been duplicated on the fixed asset register. The value of these properties was £3.2m, this had already been adjusted by the authority in the accounts approved by Committee and is therefore not included within Appendix D where we show our audit adjustments. We recommend that the Authority reviews all items within the Fixed Asset register which have not been revalued recently to ensure that these assets are still owned by the Council. This indication of control weakness is considered serious but mitigated as the Authority were aware of this prior to our audit.	Agreed. More comprehensive controls on the reconciliation of receipts from the sale of assets and the asset register were introduced in 2007/08. The assets identified as sold related to assets disposed of before this improvement in the control environment. A review of assets which have yet to be revalued since the changes were introduced will be undertaken to ensure all assets are properly accounted for. In addition there will also be a review of the Council's Asset Register for any indication of duplicate assets. **Action - Principle Accountant, Corporate Financial Management.** **Due date – April 2011.**

Appendix C: Recommendations

No.	Priority	Issue & Recommendation	Management Response / Responsible Officer / Due Date
2	2	**Fixed Asset Valuations** During our work we identified three assets which had been revalued during the year, however these revaluations (upwards) had not been reflected in the fixed asset register. Further review found two more assets where the same situation occurred. This has resulted an increase to the Fixed Asset balance in the accounts of £1.942m. The Authority should ensure that all fixed asset valuations are updated to the Fixed Asset Register each year.	Agreed. One definitive list of all asset valuations in year to be agreed between Corporate Financial Management and the Council's valuer. This definitive list will provide a control total for the Asset Register. **Action - Principle Accountant, Corporate Financial Management. Due date – April 2011.**

Appendix D: Audit differences

The following table sets out the significant audit difference identified by our audit of Leeds City Council's financial statements for the year ended 31 March 2010.

We are pleased to report that there have been no uncorrected differences in this years audit

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 the Authority's case is the Corporate Governance and 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.

Corrected audit difference

The following table sets out the significant audit difference identified by our audit of Leeds City Council's financial statements for the year ended 31 March 2010.

There have been a number of other adjustments which have been made by the Authority as a result of their own Quality Assurance and review processes, this significant movements include a revision of the pension entries (£115m on the I&E) and some movements between headings on the I&E account (from central services to Children's and exceptional items) total value circa £9m. None of these changes affect the movement on General Fund Balance for the year. These adjustments were necessary to ensure that the different lines on the face of the I&E were correct and in line with prior years. In addition to this we have also recommended a number of minor changes be made to some disclosures in the accounts so that they are brought in line with the Statement Of Recommended Practice (SORP).

Impact					Basis of audit difference
Income and expenditure	Statement of Movement on GF Balance	Assets	Liabilities	Reserves	
		Dr Tangible Fixed Assets £1,942k		Cr Revaluation Reserve £1,942k	During or work we identified three assets which had been revalued during the year but this revaluation (upwards) had not been reflected in the fixed asset register. Further review of this found two more assets where the same situation occurred
Dr Children's Services NCS (08-09) £2,400k Cr Government grants (08-09 £2,400k)					Our review of PFI entries for 08-09 found one area where government grant had not been correctly removed from Children's services and rec-classified in the government grant line.
0	**0**	**Dr 1,942k**	**0**	**Cr 1,942**	**Total impact of adjustments**

Appendix E: Declaration of independence and objectivity

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

Requirements

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

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

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

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

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

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 Audit Partner and the audit team.

Appendix E: 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.

General procedures to safeguard independence and objectivity

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

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

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

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

Auditor Declaration

In relation to the audit of the financial statements of Leeds City Council for the financial year ending 31 March 2010, we confirm that there were no relationships between KPMG LLP and the Leeds City Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

Appendix F: Draft management representation letter

We ask you 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.

The wording for these representations is standard and prescribed by auditing standards.

We require a signed copy of your management representations before we issue our audit opinion.

Dear KPMG LLP,

We understand that auditing standards require you to obtain representations from management on certain matters material to your opinion. Accordingly we confirm to the best of our knowledge and belief, having made appropriate enquiries of other members of the Authority, the following representations given to you in connection with your audit of the financial statements for Leeds City Council for the year ended 31 March 2010.

All the accounting records have been made available to you for the purpose of your audit and the full effect of all the transactions undertaken by Leeds City Council has been properly reflected and recorded in the accounting records in accordance with agreements, including side agreements, amendments and oral agreements. All other records and related information, including minutes of all management and Committee meetings, have been made available to you.

We confirm that we have disclosed all material related party transactions relevant to the Authority and that we are not aware of any other such matters required to be disclosed in the financial statements, whether under FRS 8 or other requirements.

We confirm that we are not aware of any actual or potential non-compliance with laws and regulations that would have had a material effect on the ability of the Authority to conduct its business and therefore on the results and financial position to be disclosed in the financial statements for the year ended 31 March 2010.

We acknowledge that we are responsible for the fair presentation of the financial statements in accordance with the Local Government Statement of Recommended Practice (“SORP”) and wider UK accounting standards. We have considered and approved the financial statements.

We confirm that we:

- understand that the term “fraud” includes misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Misstatements resulting from fraudulent financial reporting involve intentional misstatements or omissions of amount or disclosures in financial statements to deceive financial statement users. Misstatements resulting from misappropriation of assets involve the theft of an entity’s assets, often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorisation;
- are responsible for the design and implementation of internal control to prevent and detect fraud and error;
- have disclosed to you our knowledge of fraud or suspected fraud affecting the Authority involving:
  - management;
  - employees who have significant roles in internal control; or
  - others where the fraud could have a material effect on the financial statements.
- have disclosed to you our knowledge of any allegations of fraud, or suspected fraud, affecting the Authority’s financial statements communicated by employees, former employees, analysts, regulators or others; and
- have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

Appendix F: Draft management representation letter (continued)

We are seeking specific representations with respect to PFI, a Yorkshire Forward grant conditions, and finally the Housing Revenue and Highways expenditure and disclosure.

We confirm that the presentation and disclosure of the fair value measurements of material assets, liabilities and components of equity are in accordance with applicable reporting standards. The amounts disclosed represent our best estimate of fair value of assets and liabilities required to be disclosed by these standards. The measurement methods and significant assumptions used in determining fair value have been applied on a consistent basis, are reasonable and they appropriately reflect our intent and ability to carry out specific courses of action on behalf of the Authority where relevant to the fair value measurements or disclosures.

We confirm that there are no other contingent liabilities, other than those that have been properly recorded and disclosed in the financial statements. In particular:

- there is no significant pending or threatened litigation, other than that already disclosed in the financial statements; and
- there are no material commitments or contractual issues, other than those already disclosed in the financial statements.

With reference to the specific issues on which you have requested assurances from Members, we confirm that:

- All expenditure contained within the Housing Revenue Account (HRA) has been used to fund HRA activities;
- All capitalised expenditure relating to Highways is fully compliant with the requirements of FRS 15 (Tangible Fixed Assets); and
- The Council has no liability in respect of the £10.5m grant from Yorkshire Forward for the East Leeds Link Road.

Finally, no additional significant post balance sheet events have occurred that would require additional adjustment or disclosure in the financial statements, over and above those events already disclosed.

This letter was tabled at the meeting of the Corporate Governance and Audit Committee on 29 September 2010

Yours faithfully

Alan Gay – Deputy Chief Executive and Director of Resources

On behalf of Leeds City Council