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# VFM audit approach 2010/11

Leeds City Council

March 2011



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in connection with this  
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This report is addressed to Leeds City Council (the "Council") and has been prepared for your use only. We accept no responsibility towards any member of staff acting on their own, or to any 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 Council. We draw your attention to this document.

External auditors do not act as a substitute for the Council'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 lead to the Council (telephone 0121 3352440 or 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 246 4000 or 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 Unit Manager, Audit Commission, 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.

### Our audit is divided into:

- Use of resources; and
- Financial statements.

This document describes how the Audit Commission's new VFM audit approach will operate to fulfil our use of resources responsibilities.

It also sets out our revised risk assessment for our VFM conclusion.

### Our responsibilities

Our statutory responsibilities and powers are set out in the Audit Commission Act 1998 (the Act) and the Commission's *Code of Audit Practice* (the Code). The Code summarises our responsibilities into two objectives, requiring us to review and report on your:

- *use of resources*: concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the value for money (VFM) conclusion); and
- *financial statements* (including the Annual Governance Statement): providing an opinion on your accounts.

We have already provided information on our detailed financial statements audit approach in our separate Financial Statements Audit Plan 2010/11, which also includes other aspects we are required to communicate, such as independence declarations and fee disclosures.

This document focuses on our VFM audit. It describes the new approach introduced this year by the Audit Commission and highlights the key changes compared to the previous Use of Resources (UoR) auditor's scored judgements regime. The approach outlined in this document reflects the Audit Commission requirements for our VFM conclusion.

It also sets out our revised risk assessment for our VFM conclusion.

### VFM audit approach

The new approach is structured around two criteria:

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

These replace the ten criteria/ key lines of enquiry under the previous UoR audit regime. There are no scored judgements under the new approach and the VFM conclusion is the only output. This remains a 'pass / fail' style assessment.

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

Our VFM audit will draw heavily on other audit work which is relevant to our VFM responsibilities and the results of last year's VFM audit. As part of the process we will issue the Authority with a self-assessment to complete which may indicate further risks and areas that we will focus upon. Throughout this process we will assess if more detailed audit work is required in specific areas. Should this be appropriate the Audit Commission have developed a range of audit tools and review guides which we will draw upon where relevant.

This document describes how the new VFM audit approach will operate to fulfil our use of resources responsibilities.

It also sets out our revised risk assessment for our VFM conclusion.

### Risk assessment

The risks to our VFM conclusion we have identified are:

Risk	Description
<b>Managing with less</b>	<p>Following the Spending Review in October 2010, the Council needs to deliver nearly £90m of savings in 2011/12, which is almost 10% of the Council's net spending before grants. Whilst an approved budget plan has now been approved this still represents a significant challenge for the Council.</p> <p>We will review the Council's financial planning following the 2011/12 settlement, focusing in particular on the capacity of the Council's 2011/12 budgets to secure a stable financial position. We will also consider the actions taken by the Council to effectively manage financial risks and opportunities.</p>
<b>Early Leavers Initiative</b>	<p>Following the recent budget cuts, the Council by the end of 2011/12 will have lost over 1,500 jobs compared to the position at the start of the 2010/11 financial year.</p> <p>We will consider how the Council has ensured that its decisions on cost reductions and service cuts reflect local priorities and will achieve long term sustainable savings.</p>
<b>Waste management</b>	<p>As part of the vision for waste management in Leeds, the Council are proposing to build a treatment facility to deal with waste that cannot be recycled.</p> <p>The Council have narrowed the original eight bidders down to two and the successful bidder will be chosen in Summer 2011. Public consultation will then commence later in 2011, with construction planned to commence in 2013.</p> <p>We will take into consideration how the Council ensures that the waste management plan is affordable and tailored to local needs, delivering value for money. This project is an example of a large scale procurement exercise undertaken by the Council and a review of the procedures followed for this may indicate further risks that could lead to additional VFM work being undertaken.</p> <p>This work is particularly relevant to the economy, efficiency and effectiveness criterion of the VFM conclusion.</p>

We will report on the results of our VFM audit work through our Interim Audit Report and our Report to those charged with governance.

Our work this year on your use of resources arrangements will follow a new approach introduced by the Audit Commission.

### Background to new approach to local VFM work

The financial environment in which public sector audited bodies operate has changed significantly in the last two years. In particular, the recession, the state of the UK's public finances, and the scale of funding cuts have led to increased pressure on public spending.

In response to the changing financial environment, the Audit Commission has introduced a new approach to local VFM work at those bodies previously subject to a UoR assessment. The new, more focused approach will focus the work auditors do on areas of identified audit risk to meet their statutory VFM responsibilities.

The principles the Commission has used to develop the new approach to local VFM audit work are that it should:

- enable auditors to fulfil their responsibility under the Act and the Code, relating to an audited body's arrangements to secure economy, efficiency and effectiveness;
- be sharper and more focused than the UoR assessment and allow for greater linkages to our financial statements audit work; and
- apply proportionately to reflect the size, capacity and performance of different types of audited body and, as far as possible, operate consistently across all sectors of the Commission's regime.

In meeting their statutory responsibilities relating to economy, efficiency and effectiveness, the Commission's Code requires auditors to:

- plan their work based on consideration of the significant risks of giving a wrong conclusion (audit risk); and
- carry out only as much work as is appropriate to enable them to give a safe VFM conclusion.

The new approach is structured under two themes, as summarised below.

Specified criteria for VFM conclusion	Focus of the criteria	Sub-sections
The organisation has proper arrangements in place for securing <b>financial resilience</b> .	The organisation has robust systems and processes to: <ul style="list-style-type: none"> <li>■ manage effectively financial risks and opportunities; and</li> <li>■ secure a stable financial position that enables it to continue to operate for the foreseeable future.</li> </ul>	<ul style="list-style-type: none"> <li>■ Financial governance</li> <li>■ Financial planning</li> <li>■ Financial control</li> </ul>
The organisation has proper arrangements for challenging how it <b>secures economy, efficiency and effectiveness</b> .	The organisation is prioritising its resources within tighter budgets, for example by: <ul style="list-style-type: none"> <li>■ achieving cost reductions; and</li> <li>■ improving efficiency and productivity.</li> </ul>	<ul style="list-style-type: none"> <li>■ Prioritising resources</li> <li>■ Improving efficiency and productivity</li> </ul>

These tables provide further details on the types of questions that relate to each of the sub sections contained within the two main VFM criteria, financial resilience and securing economy, efficiency and effectiveness as detailed by the Audit Commission.

Sub Sections – Financial resilience	Examples of relevant areas to probe
Financial governance	<ul style="list-style-type: none"> <li>Does the leadership team understand the financial challenges facing LCC and is the leadership team taking appropriate action to secure a stable financial position?</li> <li>Does the leadership team foster an environment where there is good understanding, transparency and routine challenge of financial assumptions and performance?</li> <li>Do the leadership and Members provide constructive scrutiny and challenge on financial matters?</li> <li>Does the organisation have an objective, knowledgeable and effective audit committee?</li> </ul>
Financial planning	<ul style="list-style-type: none"> <li>Does medium-term financial planning and annual budgeting reflect the organisation's strategic objectives and priorities for the year and the longer term?</li> <li>Does the organisation understand its sources of income and the risks arising from these; has it reviewed its approach to fees and charges to ensure it achieves value for money?</li> <li>Does the organisation's treasury management arrangements ensure it has sufficient cash to meet its needs - achieving a balance between security, liquidity and yield?</li> <li>What processes and procedures are in place in terms of modelling, options appraisals and risk assessment?</li> </ul>
Financial control	<ul style="list-style-type: none"> <li>Is the organisation's financial monitoring and forecasting fit-for purpose?</li> <li>Does the organisation have a good recent record of operating within its budget with no significant overspends?</li> <li>Does the organisation set and monitor challenging targets for the collection of income and arrears?</li> <li>Does the organisation monitor and use its key financial ratios and benchmark them?</li> </ul>
Sub Sections – Securing economy, efficiency and effectiveness	Examples of relevant areas to probe
Prioritising resources	<ul style="list-style-type: none"> <li>Does the organisation have strong leadership and the capacity to deliver the spending reductions required of it?</li> <li>Is the organisation reviewing its strategic priorities and the cost-effectiveness of its activities' and is there input from or consultation with front-line staff and local residents to identify local priorities?</li> <li>Does the organisation base its decisions on cost reductions and prioritising its resources on robust information?</li> <li>Does the organisation have a good track record of identifying and challenging areas of high spending, and of effective action to deliver cost reductions?</li> </ul>
Improving efficiency and productivity	<ul style="list-style-type: none"> <li>Does the organisation have access to good quality, timely comparative information on costs and performance and is this information being used to evaluate options and plans for efficiency savings?</li> <li>Is the organisation using alternative and innovative approaches to delivering services?</li> <li>Is the organisation using a robust approach to evaluating options for making efficiencies?</li> <li>Is the organisation setting itself challenging targets, and working with others to achieve its priorities?</li> </ul>

## Section two VFM audit approach (continued)

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

### Overview of the VFM audit approach

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



Each of these stages are summarised further below.

VFM audit stage	Audit approach
	<p><b>VFM audit risk assessment</b></p> <p>We will consider the relevance and significance of the potential business risks faced by all Local Authorities, and other risks that apply specifically to the Council . These are the significant operational and financial risks in achieving statutory functions and objectives, which are relevant to auditors' responsibilities under the Code.</p> <p>In doing so we will consider:</p> <ul style="list-style-type: none"> <li>the Council's own assessment of the risks it faces, and its arrangements to manage and address its risks;</li> <li>information from the Audit Commission's VFM profile tool and financial ratios tool;</li> <li>evidence gained from previous audit work, including the response to that work;</li> <li>evidence gained from the Council's self assessment; and</li> <li>the work of the Audit Commission, other inspectorates and review agencies (where relevant to our VFM audit responsibilities).</li> </ul> <p>In light of the revised criteria we have updated our risk assessment for our VFM audit work and a summary of risks is included in the next section of this report.</p>

Our VFM audit will draw heavily on other audit work which is relevant to our VFM responsibilities and the results of last year's VFM audit.

We will then form an assessment of residual audit risk to identify the areas where more detailed VFM audit work is required.

**Overview of the VFM audit approach (continued)**

VFM audit stage	Audit approach
	<p><b>Linkages with financial statements and other audit work</b></p> <p>There is a degree of overlap between the work we do as part of the VFM audit and our financial statements audit. For example, our financial statements audit includes an assessment and testing of the Council's financial management and governance arrangements, many aspects of which are relevant to our VFM audit responsibilities.</p> <p>We have always sought to avoid duplication of audit effort by integrating our financial statements and VFM work, and this will continue. We will therefore draw upon relevant aspects of our financial statements audit work to inform the VFM audit. In practice, this work will involve a range of interviews with relevant officers, review of documents such as policies, plans and minutes, and testing of certain controls. We will make use of any self assessment the Council undertakes against the detailed characteristics.</p> <p>We will also have regard to the results of previous VFM audit work and any other relevant audit work undertaken in the year.</p>
	<p><b>Assessment of residual audit risk</b></p> <p>It is likely that further audit work will be necessary in some areas to ensure comprehensive coverage of the two VFM criteria.</p> <p>This work will involve a range of interviews with relevant officers, and review of documents such as policies, plans and minutes. We will also refer to any self assessment the Council may prepare against the characteristics.</p> <p>To inform any further work we must draw together an assessment of residual audit risk, taking account of the work undertaken already. This will identify those areas requiring further specific audit work to inform the VFM conclusion.</p> <p>At this stage it is not possible to indicate the number or type of residual audit risks that might require additional audit work, and therefore the overall scale of work cannot be easily predicted.</p>

We will identify what additional VFM audit work is required and, where relevant, draw upon the range of audit tools and review guides developed by the Audit Commission.

### Overview of the VFM audit approach (continued)

VFM audit stage	Audit approach
	<p><b>Identification of specific VFM audit work</b></p> <p>If we identify residual audit risks, then we will highlight the risk to the Council and consider the most appropriate audit response in each case, including:</p> <ul style="list-style-type: none"> <li>considering the results of work by the Council, the Audit Commission, other inspectorates and review agencies; and</li> <li>carrying out local risk-based work to form a view on the adequacy of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources.</li> </ul>
	<p><b>Delivery of local risk based work</b></p> <p>Depending on the nature of the residual audit risk identified, we will be able to draw on the following audit tools and sources of guidance when undertaking specific local risk-based audit work:</p> <ul style="list-style-type: none"> <li>local savings review guides based on selected previous Audit Commission national studies;</li> <li>update briefings for previous Audit Commission studies.</li> </ul> <p>These are discussed in further detail in Appendix A. Any detailed work will also make reference to the detailed VFM characteristics, as appropriate, and any self assessment the Council may prepare against the characteristics.</p> <p>The tools and guides will support our work where we have identified a local risk. For any residual audit risks that relate to issues not covered by one of these tools, we will develop an appropriate audit approach drawing on the detailed VFM guidance and other sources of information.</p>
	<p><b>Concluding on VFM arrangements</b></p> <p>At the conclusion of the VFM audit we will consider the results of the work undertaken and assess the assurance obtained against each of the VFM themes regarding the adequacy of the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources.</p> <p>If any issues are identified that may be significant to this assessment, and in particular if there are issues that indicate we may need to consider qualifying our VFM conclusion, we will discuss these with management as soon as possible. Such issues will also be considered more widely as part of KPMG's quality control processes, to help ensure the consistency of auditors' decisions.</p>

The output of the VFM audit is our opinion on the arrangements in place to deliver VFM, known as the VFM conclusion.

**Overview of the VFM audit approach (continued)**

VFM audit stage	Audit approach
	<p><b>Reporting</b></p> <p>We do not plan to produce a separate report on the VFM audit, either overall or for any local savings reviews that we may undertake. Instead, we will report on the results of the VFM audit through our Interim Audit Report and our Report to those charged with governance. These reports will summarise our progress in delivering the VFM audit, the results and any specific matters arising, and the basis for our overall conclusion.</p> <p>The key output from the work will be the VFM conclusion (i.e. our opinion on the Council's arrangements for securing VFM). This will be delivered through the audit report that we issue on the Council's financial statements.</p> <p>The VFM conclusion will be one of the following:</p> <ul style="list-style-type: none"> <li>■ unqualified – meaning we are happy that in all significant respects the Council has proper arrangements for securing economy, efficiency and effectiveness in the use of its resources; or</li> <li>■ except for qualification – meaning we are generally satisfied with the adequacy of the arrangements in place, except for one or more specific issues highlighted during the audit that relate to specific VFM criteria; or</li> <li>■ adverse qualification – meaning we are unable to conclude that the Council has adequate arrangements in place.</li> </ul> <p>In practical terms, issues that would have led to level 1 score under the previous UoR regime will continue to require auditors to consider the need for some form of qualification of the VFM conclusion.</p>

There are many similarities to the previous Use of Resources approach, but also some notable differences.

### Comparison to the previous Use of Resources audit regime

Although the purpose of the VFM audit remains the same – to form a view on the adequacy of the Council’s arrangements for securing economy, efficiency and effectiveness in the use of its resources – and there are many similarities in the new approach, there are also some notable differences. These are summarised in the table below.

Previous Use of Resources audit regime	New VFM audit regime
<ul style="list-style-type: none"> <li>Three themes (managing finances, governing the business and managing resources) covering ten key lines of enquiry (KLOE). VFM criteria equate to KLOE.</li> </ul>	<ul style="list-style-type: none"> <li>Reduced to two VFM criteria (financial resilience and securing VFM). There remains considerable overlap in coverage, but some aspects (e.g. natural resources) are not now considered.</li> </ul>
<ul style="list-style-type: none"> <li>Scored judgements overall, for each of the three themes and each KLOE. These scores informed the VFM conclusion.</li> </ul>	<ul style="list-style-type: none"> <li>No scored judgements. The VFM conclusion is the only output, which remains a 'pass / fail' style assessment.</li> </ul>
<ul style="list-style-type: none"> <li>Detailed guidance available for each KLOE describing the standards and performance required to achieve levels 2 and 3.</li> </ul>	<ul style="list-style-type: none"> <li>More summarised characteristics replace the previous KLOEs. These have an austerity flavour and are more concerned with the current focus on issues such as savings and efficiencies.</li> </ul>
<ul style="list-style-type: none"> <li>Strong emphasis on the need to demonstrate impact and positive outcomes to achieve higher scores.</li> </ul>	<ul style="list-style-type: none"> <li>Focus is on the adequacy of the arrangements to deliver economy, efficiency and effectiveness in the use of resources.</li> </ul>
<ul style="list-style-type: none"> <li>Some cyclical variation each year, but Use of Resources audits were applied in the same way at every audited body.</li> </ul>	<ul style="list-style-type: none"> <li>Risk-based approach with the level of audit work varying at each audited body.</li> </ul>

**We have identified a number of significant risks to our VFM conclusion.**

**We will consider the arrangements put in place by the Council to mitigate these risks and plan our work accordingly.**

### VFM risks identified

Our Audit Fee Letter 2010/11 included the initial risk assessment for our VFM audit work. We have updated this in light of the revised criteria and a summary of risks is included in the table below.

In most cases, it is not possible to indicate at this stage exactly what audit work will be required. As described earlier in this report, our work is likely to include interviews with relevant officers, and review of documents such as policies, plans and minutes. Depending on our residual audit risk, we may then need to complete targeted further work.

Risk	Focus of work
<p><b>Managing with less</b></p> <p>Following the Spending Review in October 2010, the Council needs to deliver nearly £90m of savings in 2011/12, which is almost 10% of the Council's net spending before grants. Whilst an approved budget plan has now been approved this still represents a significant challenge for the Council.</p> <p>In order to deliver these savings, the Council will be undertaking significant change programmes across services.</p> <p>It will need to ensure that it effectively manages financial risks and opportunities and that it puts in place plans that secure a stable financial position and enables it to continue to operate for the foreseeable future.</p>	<p>The Commission will be publishing a national study in May 2011 on the impact of the 2011/12 local government settlement on councils' finances. The study will examine the approaches taken by councils in responding to the need to make savings and to managing with less.</p> <p>To support the study, we are required to complete a survey which will capture:</p> <ul style="list-style-type: none"> <li>• information on the financial stability of the Council following the 2011/12 settlement, focusing in particular on the capacity of the Council's 2011/12 draft budgets to secure this stability; and</li> <li>• actions used by the Council to secure the necessary savings in its 2011/12 draft budget and any resulting implications for service provision.</li> </ul> <p>We will also critically assess the Council's financial standing to ensure that its Medium Term Financial Plan and planning has duly taken into consideration the potential funding reductions and that it is sufficiently robust to ensure that the Council can continue to provide services effectively.</p> <p>The information collected in the survey will be closely based on the financial resilience criterion of the VFM conclusion and forms a mandatory part of auditors' work programmes at all single-tier, county and district councils.</p>

**We have identified a number of significant risks to our VFM conclusion.**

**We will consider the arrangements put in place by the Council to mitigate these risks and plan our work accordingly.**

Risk	Focus of work
<p><b>Early Leavers Initiative</b></p> <p>Following the recent budget cuts, the Council by the end of 2011/12 will have lost over 1,500 jobs compared to the position at the start of the 2010/11 financial year.</p> <p>The Council will need to ensure that its reduced resources are focused on its key strategic priorities and that the impact on service delivery is kept to a minimum.</p>	<p>We will consider how the Council has ensured that its decision on cost reductions and service cuts reflect local priorities and will achieve long-term sustainable savings.</p> <p>This work is relevant to both the financial resilience and economy, efficiency and effectiveness criteria of the VFM conclusion.</p>
<p><b>Waste management</b></p> <p>As part of the vision for waste management in Leeds, the Council are proposing to build a treatment facility to deal with waste that cannot be recycled.</p> <p>The Council have narrowed the original eight bidders down to two and the successful bidder will be chosen in Summer 2011. Public consultation will then commence later in 2011, with construction planned to commence in 2013.</p> <p>The Council will need to ensure that the scheme generates the envisaged benefits for the Council and delivers value for money.</p>	<p>We will take into consideration how the Council ensures that the waste management plan is affordable and tailored to local needs, delivering value for money.</p> <p>This project is an example of a large scale procurement exercise undertaken by the Council and a review of the procedures followed for this may indicate further risks that could lead to additional VFM work being undertaken.</p> <p>This work is particularly relevant to the economy, efficiency and effectiveness criterion of the VFM conclusion.</p>

The Audit Commission has developed a range of VFM tools and review guides that we can draw upon when undertaking VFM audit work on any detailed risk areas.

The local savings reviews are light-touch guides, with comparative data where available. Use of the tools and review guides is not mandatory and auditors are not therefore required to undertake work on the topics covered as a matter of course. The tools and guides will support auditors' work where we have identified a local risk through the risk assessment. Also, they can be applied flexibly so we may decide to only use them in part rather than fully, depending on the nature of the residual audit risk to be addressed.

### Local savings review guides

The Audit Commission has developed the following local savings review guides which auditors can use to inform local VFM work on appropriate residual audit risks.

Review Guide	Description
<p><b>Back to front: efficiency of back office functions in local government</b></p> <p><a href="#">Link</a></p>	<p>The original 2008 national study found there were still opportunities for back office savings. The savings review guide focuses on arrangements to deliver savings including delivery arrangements, governance processes, plans and good information.</p> <p>The results of work on this topic may provide evidence for the VFM conclusion criterion on how organisations are challenging the way they secure economy, efficiency and effectiveness.</p>
<p><b>The efficiency challenge: the administration costs of revenues and benefits</b></p> <p><a href="#">Link</a></p>	<p>The 2005 national study identified potential efficiency savings of £140 million. The savings review guide focuses on the arrangements needed to deliver these potential savings, including:</p> <ul style="list-style-type: none"> <li>■ delivery arrangements (for example in-house, contracted out or shared);</li> <li>■ governance; and</li> <li>■ good information.</li> </ul> <p>The results of work on this topic may provide evidence for the VFM conclusion criterion on how organisations are challenging the way they secure economy, efficiency and effectiveness.</p>

The Audit Commission has developed a range of VFM tools and review guides that we can draw upon when undertaking VFM audit work on any detailed risk areas.

### Audit Commission national study update briefings

The Audit Commission has developed the following national study update briefings which auditors can use to inform local VFM work on appropriate residual audit risks:

- [Room for improvement: A review of strategic asset management](#);
- [Positively charged: maximising the benefits of local public service charges](#); and
- [Sustaining value for money in the police service](#).

If used, these update briefings will be useful when considering whether the Council is using sources of good practice to challenge arrangements for securing VFM (see securing economy, efficiency and effectiveness criterion). The *Positively charged* update briefing may also be relevant to the financial resilience criterion.



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