

Annual Audit Letter 2010/11

Leeds City Council

November 2011

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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 which is available on the Audit Commission's website at www.auditcommission.gov.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.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Mike McDonagh, the appointed engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, or by email to 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.

This report summarises the key findings from our 2010/11 audit of Leeds City Council (the Authority).

Although this letter is addressed to the Members of the Authority, it is also intended to communicate these issues to key external stakeholders, including members of the public.

Our work consists of the audit of the Authority's 2010/11 financial statements and the 2010/11 VFM conclusion.

<p>VFM conclusion</p>	<p>We issued an unqualified value for money ('VFM') conclusion for 2010/11 on 30 September 2011.</p> <p>This means we are satisfied that you have proper arrangements for securing financial resilience and challenging how you secure economy, efficiency and effectiveness in your use of resources.</p> <p>To arrive at our conclusion we looked at your financial governance, financial planning and financial control processes, as well as how you are prioritising resources and improving efficiency and productivity.</p>
<p>VFM risk areas</p>	<p>We identified a number of significant risks to our VFM conclusion and considered the arrangements you have put in place to mitigate these.</p> <p>Our work identified the following significant matters:</p> <p>Managing with Less - The Authority has put in place arrangements following the Government's Comprehensive Spending Review (CSR) to ensure that it achieves its objectives. Achievement of the 2010-11 budget and strong uptake on the Early Leavers Initiative has shown that the Authority is responding to the challenges it faces. To date, 1,500 staff have left the Authority. The Authority has delivered a surplus of £13.5 million against its budgeted position for the year. This is against a backdrop of overspends totalling £10.3 million in directorates, mainly in Adult's and Children's Services. The Authority has identified these services as risk areas and continues to seek early intervention throughout the year. These overspends were offset by corporate savings of £23.8 million.</p> <p>The Authority has achieved its £13.5 million underspend with a relative low level of reserves (including earmarked reserves) as a percentage of spending power (with 4% compared to the average core city of 14%) and whilst facing funding reductions which are relatively greater than other authorities. The Authority has always operated within a level of reserves it has felt prudent and has added to these with the surplus reported this financial year.</p> <p>The results of the Audit Commission financial resilience survey did not identify any areas of major concern when assessing the VFM arrangements at the Authority.</p> <p>The scale of the challenge ahead is not to be underestimated and key to this will be managing the overspends in Adult's and Children's Services which as at the end of July 2011 were showing overspends of £10.6 million. The latest reported figure now stands at £7.6 million).</p> <p>The Authority therefore needs to ensure that it continually monitors the Medium Term Financial Plan and takes appropriate early interventions to manage their financial pressures.</p>

VFM risk areas -
continued

Early Leavers Initiative (ELI) - As a result of the significant financial pressures faced by the Authority, the Executive Team approved an early Authority-wide ELI. The rationale for the introduction of this scheme was to provide the Authority with a mechanism to help respond to the financial challenges it faced.

Initial targets for the first phase of the ELI was for 1,000 employees to leave the Authority achieving around £20 million of savings. These figures were determined to support a balanced budget rather than being as a result of a review of staffing to support future service delivery. The Authority has maximised the savings achieved through this initiative by not stopping when it reached its target of 1,000. The Authority continued reviewing individual applications against the business case criteria and drove through extra savings as a result. In total savings from 1,159 employee posts have been released as at 31 March 2011. The number of ELI approved cases was 890, with the remainder achieved through not recruiting as employees have left the Authority.

The Authority is also in a second phase of the ELI and has target figures of between 350 – 400 early leavers to be achieved through this process in the current financial period. This is also a continual process for the Authority and going forward, due to the continual improvements in service planning, the Authority plans to move to an approach whereby the resourcing team will look at the future delivery method of services. This will be used to identify the future structure of the directorates. This will be used to identify the target numbers for staffing numbers within the Authority based on the most effective, efficient method of service delivery.

Waste Management – The Authority currently sends over 50% of the waste produced by the residents of Leeds to landfill, for which the costs keep escalating. For a number of years, the Authority has been seeking a more cost effective method of waste management. To achieve this, the Authority plans to continually improve its recycling targets and develop a 'residual waste' strategy. To manage this 'residual waste' strategy the Authority commenced the procurement of a contract to treat the Authority's residual waste in 2008. The Authority short listed the participants down to two bidders who have both submitted their final tenders. Proposed recommendations are due to go to the Executive Board in November. It is expected that the facility will become fully operational in March 2016.

Throughout the life of this project the Authority has sought technical, legal and financial advice from external advisors including DLA, PwC and Jacobs and the internal team within the Public Private Partnership Unit (PPPU). This expert advice has been called upon to undertake a technical review of the technology to be used in this facility and the Authority were satisfied with the assumptions used to underpin this work.

The Authority have also sought external advice to determine what the cost would be for the Authority to do nothing and to continue as they are. The costs of the 'do nothing' model are significantly higher than the costs of the 'residual waste' strategy. The overall objective of this project is to achieve a break even position and, if possible, achieve a saving in net terms.

There remain some potential risks that need to be managed by the Authority including the fact that the facility has the potential to be either a combined heat and power (CHP) enabled or deliverable scheme.

We provide a summary of our key recommendations in Appendix 1.

All the issues in this letter have been previously reported. The detailed findings are contained in the reports we have listed in Appendix 2.

Annual Governance Statement	We reviewed your <i>Annual Governance Statement</i> and concluded that it was consistent with our understanding.
Audit opinion	We issued an unqualified opinion on your financial statements on 30 September 2011. This means that we believe the financial statements give a true and fair view of the financial position of the Authority and of its expenditure and income for the year.
Financial statements audit	<p>Our audit identified no significant audit adjustments. There were a small number of presentational adjustments required to ensure that the accounts are compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2010.</p> <p>Management did however identify one 'event after the reporting date' with a total value of £8.4 million. This related to the contingent asset, which is an asset where the possibility of receipt depends solely upon a future event, in the Authority's draft accounts. This was in respect of a VAT claim for Trade Waste. Since the year end HMRC have confirmed to the Authority, in writing, that this claim will be paid. Therefore, in accordance with accounting standards, the receipt of this letter confirms that the money from HMRC will be received and so this is classed as an 'adjusting event'. This meant that this income was recognised in the 2010/11 accounts and a corresponding debtor raised with HMRC.</p> <p>The impact of this was to:</p> <ul style="list-style-type: none"> ▪ increase the balance on the general fund account as at 31 March 2011 by £8.4 million; ▪ increase the surplus on provision of services for the year by £8.4 million; and ▪ increase the net worth of the Authority as at 31 March 2011 by £8.4 million.
High priority recommendations	We raised no high priority recommendations as a result of our 2010/11 work. We have detailed both medium priority recommendations in Appendix 1 together with the action plan agreed by management.
Certificate	<p>We issued our certificate on 30 September 2011.</p> <p>The certificate confirms that we have concluded the audit for 2010/11 in accordance with the requirements of the <i>Audit Commission Act 1998</i> and the Audit Commission's <i>Code of Audit Practice</i>.</p>

Audit fee

As per the Audit Fee Letter issued at the beginning of the year our indicative fee for the 2010/11 audit was set at £570,000, although a rebate of £39,617 was given to the Authority to subsidise the 'one-off' element of the audit cost of the transition to International Financial Reporting Standards, reducing the fee to £530,383. This was significantly below the recommended Audit Commission mid point fee of £598,500.

In year we have also provided additional services to the Authority at no additional cost. This has included employment tax advice relating to the Early Leavers Initiative (ELI) and advice from our business intelligence team on the design of the financial dashboard monitoring that the Authority are looking to introduce. KPMG has absorbed this cost of approximately £10,000

We also undertook extra work as part of our audit in looking at an innovative accounting treatment proposed by the Authority. It is expected that we would look to recover our costs and charge a fee for this kind of unforeseen extra work but KPMG has absorbed this cost of approximately £11,000.

At the request of the Corporate Governance and Audit Committee and in recognition of the financial pressures the Authority is under we agreed to review this fee upon completion of our audit to identify whether reduction in fee could be given to the Authority. We are pleased to report that KPMG have agreed to provide the Authority with a rebate of £5,500 as a gesture of goodwill.

*Overall based on the scale rate this represents a reduction of **£55,000 or 9.1%**.*

Appendix 1: Key issues and recommendations

This appendix summarises the two medium priority recommendations that we identified during our 2010/11 audit, along with your responses to them.

Lower priority recommendations are contained, as appropriate, in our other reports, which are listed in Appendix 2.

No.	Issue and recommendation	Management response/ responsible officer/ due date
1	<p>Medium Term Financial Plan</p> <p>The results of the Audit Commission financial resilience survey did not identify any areas for major concern when we were assessing the VFM arrangements at the Authority.</p> <p>However, the scale of the challenge ahead is not to be underestimated and key to this will be managing the overspends in Adult's and Children's Services which, as at month 4 of 2011/12, are showing overspends of £10.6 million. The latest reported figure is £7.6 million.</p> <p>The Authority needs to ensure that it continually monitors its Medium Term Financial Plan and takes appropriate early intervention to manage its financial pressures.</p>	<p>Monthly in year budget monitoring is undertaken via the Executive Board. The Medium Term Financial Plan will be reviewed as part of the 2012/13 budget process.</p> <p>Responsible officer: Chief Officer Financial Management</p> <p>Due date: February 2012</p>
2	<p>Component Accounting</p> <p>Following the introduction of the CIPFA/LASAAC Code of Practice on Local Authority Accounting, Local Authorities are now required to implement component accounting across their asset base (both general fund assets and HRA assets). This requires components to be separately recognised subject to appropriate materiality thresholds. Whilst the Code refrains from outlining prescriptive measures for implementing componentisation it does state a number of guiding principles in relation to ensuring that a component is recognised if it has a significant cost and if there is a material difference between the existing depreciation charge and that which would apply if it were recognised.</p> <p>The Authority undertook an exercise, with appropriate advice from the internal valuation team, to identify any potentially significant components across both general fund and HRA buildings. As such the Authority concluded that only a small number of specialised items of plant in some of its general fund buildings met its materiality criteria for separate recognition. At our request the authority also carried out an exercise to estimate the impact on depreciation across the HRA of recognising the largest components it had identified, even though these were not individually significant. The impact on depreciation was found not to be material.</p>	<p>Response shown overleaf</p>

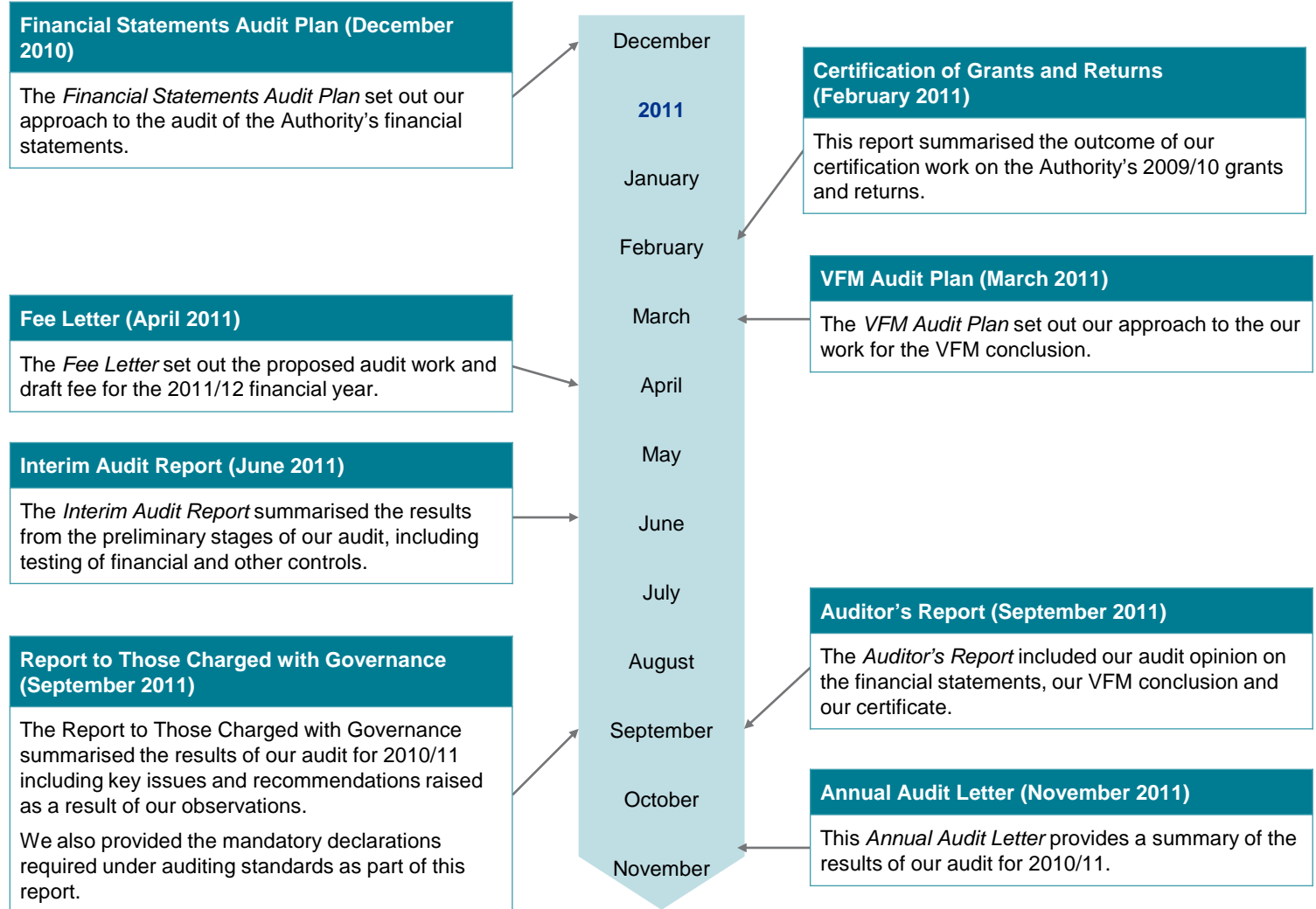
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No.	Issue and recommendation	Management response/ responsible officer/ due date
2	<p>Component Accounting - continued</p> <p>We have reviewed the appropriateness of the Council's policy against the requirements of the Code of Practice and IAS 16. In doing so we have outlined a number of considerations that the Authority should keep under review to ensure the policy is appropriate. These considerations include:</p> <ul style="list-style-type: none"> Where the level of capital expenditure in a year is significant and relates to an individual component, such as a roof, then the Authority would need to consider whether the policy is still appropriate or whether the amount spent over the class of asset should be separately accounted for as an individual component; and The impending changes to the HRA. The consultation paper issued by CIPFA in February 2011 outlined the proposed abolition of the Housing Subsidy and the MRA. This will increase the importance of an accurate depreciation charges in the HRA to ensure that suitable provisions are in place to fund major repairs to housing stock. For example, if the total replacement cost for an asset over the 30 year business plan is £33,000 then for business planning purposes, an annual depreciation charge of £1,100 would be expected. 	<p>The council will review all capital spend at the end of each year under its established accounting policy for components.</p> <p>Responsible officer: Principal accountant Corporate Financial Management.</p> <p>Implementation date: closedown 2011/12.</p> <p>The council is closely following the ongoing consultations on changes to HRA asset valuation and depreciation arrangements, and will review its own approach once the national requirements and guidance have been finalised. Responsible officer:</p> <p>Principal accountant Corporate Financial Management.</p> <p>Implementation date: As and when accounting standards are amended.</p>

Appendix 2: Summary of reports issued

This appendix summarises the reports we issued since our last *Annual Audit Letter*.





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