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Report to those charged with governance (ISA 260) 2011/12

Leeds City Council

September 2012

Contents

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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.

Introduction

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 2012; and**
- **our assessment of the Authority's arrangements to secure value for money (VFM) in its use of resources.**

We do not repeat matters we have previously communicated to you. In particular, we draw your attention to our *Interim Audit Report 2011/12*, presented to you on 4 July 2012, which summarised our planning and interim audit work.

Financial statements

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 2011/12* issued in July.

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 we have identified since we issued our Interim Audit Report 2011/12.

Our on site final accounts visit took place between 9 July 2012 and 14 September 2012. During this period, 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 are now in the final phase of the audit. Some aspects are also discharged through this report:

Completion

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

VFM conclusion

We have also now completed our work in respect of the 2011/12 VFM conclusion. This included our work to address the specific risk areas identified in our *Interim Audit Report 2011/12*.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out the key findings from our audit work in relation to the 2011/12 financial statements.
- Section 4 outlines the key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1. We have also reviewed your progress in implementing prior year recommendations and this is detailed in Appendix 2.

Acknowledgements

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

Headlines

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

Audit progress	At the date of this report, our audit of the financial statements is substantially complete. We will also report that the wording of your Annual Governance Statement accords with our understanding.
Audit adjustments	Our audit has identified one audit adjustment with a value of £16.6 million in relation to a disposal of a school which transferred to Academy status in 2012/13. The impact of this adjustment: ■ has no impact on the balance on the general fund account as at 31 March 2012; ■ decreases the deficit on provision of services for the year by £16.6 million; and ■ increases the net worth of the Authority as at 31 March 2012 by £16.6 million. We have included the detailed entries required for this audit adjustment in Appendix 3. It is our understanding that the financial statements will be adjusted by the Authority accordingly. We have also raised a number of recommendations, both in relation to the matter highlighted above and other audit matters, which are summarised in Appendix 1.
Critical accounting matters	We have worked with Officers throughout the year to discuss specific risk areas. The Authority has appropriately addressed the issues that we raised. **Financial standing (savings plans)** – The Authority has largely achieved its £90 million savings in 2011/12 and overall is £1.5 million under spent compared to the original budget at year-end, after taking account of £3.6 million strategic net savings. 636 full-time equivalent staff have left the Authority under the Early Leavers' Initiative which contributed to the achievement of almost all of the £45 million planned staff cost savings. **Component accounting** – The Authority continues to account for HRA assets on a non-component basis. The Authority has commissioned a larger, more representative sample of property valuations to support this policy in 2011/12 and the findings support the accounting methodology used. We are satisfied that the Authority's policy is in line with current guidance. We understand that the Authority will continue to consider the appropriateness of this policy going forwards and in light of any new guidance issued. **Code changes** – We reviewed the Authority's process for identifying and valuing heritage assets and are satisfied that this was reasonable. The Authority has identified £46.7 million of heritage assets as at 31 March 2011 which is considered to be material to the financial statements. The Authority has therefore made a prior period restatement and produced a third comparative balance sheet for 2009/10. The value of heritage assets at 31 March 2012 is £50.8 million, largely as a result of upwards revaluations and one purchase in year. We are satisfied that the Authority has complied with the requirements of the *2011/12 Code* in respect of heritage assets.

Headlines (continued)

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

Accounts production and audit process	The quality of the accounts and the supporting working papers has remained high. Wherever possible working papers were provided electronically as requested. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales. The Authority has implemented all of the recommendations in our *ISA 260 Report 2010/11* relating to the financial statements.
Completion	At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas: ■ Post balance sheet events review ■ Audit of provisions and exit packages ■ Final review of financial statements Before we can issue our opinion we also require a signed management representation letter. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.
VFM conclusion	We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2012.

Audit differences

Our audit has identified one audit adjustment to date.

The impact of this adjustment is to:

- **have no impact on the balance on the general fund account as at 31 March 2012;**
- **decrease the deficit on the provision of services for the year by £16.6 million; and**
- **increase the net worth of the Authority as at 31 March 2012 by £16.6 million.**

Audit differences

In accordance with ISA 260 we are required to report uncorrected audit differences to you. We also report any material misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities.

Our audit identified one significant audit difference, which we set out in Appendix 3. It is our understanding that this will be adjusted in the final version of the financial statements.

The tables on the right illustrate the total impact of audit differences on the Authority's movements on the General Fund for the year and balance sheet as at 31 March 2012. This does not reflect the impact of any adjusting post balance sheet events which may be identified. We will continue to review post balance sheet events up until 30 September 2012.

The net impact on the balance of the General Fund as at 31 March 2012 as a result of significant audit adjustments is nil.

The Authority also identified a number of amendments to the financial statements presented for audit as part of its ongoing quality assurance arrangements. These amendments have been reflected in the pre-audit figures presented in the tables.

In addition, we identified a small number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting the United Kingdom 2011/12 ('the Code')*. We understand that the Authority will be addressing these where significant.

Movements on the General Fund 2011/12

£m	Pre-audit	Audit diff.	Post-audit	*Ref App.3*
Surplus/(deficit) on the provision of services	(255.7)	16.6	(239.1)	*1*
Adjustments between accounting basis & funding basis under Regulations	256.0	-16.6	239.4	*1*
Transfers to/(from) earmarked Reserves	(4.4)	-	(4.4)	
Increase/(decrease) in General Fund	**(4.1)**	**-**	**(4.1)**	

Balance Sheet as at 31 March 2012

£m	Pre-audit	Audit diff.	Post-audit	*Ref App.3*
Property, plant and equipment	3,351.1	16.6	3,367.7	*1*
Other long term assets	115.2	(0.2)	115.0	
Current assets	145.2	-	145.2	
Current liabilities	(401.2)	-	(401.2)	
Long term liabilities	(2,929.4)	-	(2,929.4)	
Net worth	**280.9**	**16.4**	**297.3**	
General Fund	(25.4)	-	(25.4)	
Other reserves	(255.5)	(16.4)	(271.9)	*1*
Total reserves	**(280.9)**	**(16.4)**	**(297.3)**	

Annual Governance Statement

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

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 has appropriately addressed the issues.

In our *External Audit Plan 2011/12*, presented to you in February, we identified the key risks affecting the Authority's 2011/12 financial statements.

In our *Interim Audit Report 2011/12* we commented on the Authority's progress in addressing these key risks. We highlighted that the Authority was on target to achieve its planned budget, that it had performed additional work over component accounting to provide us with assurance over its chosen policy and that it was likely to make a prior period restatement in respect of heritage assets as the values were material.

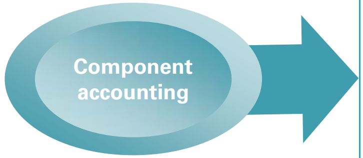
We have now completed our testing of these areas and set out our final evaluation following our substantive work and the table below sets out our detailed findings for each risk.

Key audit risk	Issue raised during planning	Findings
Financial standing – savings plans	At the end of period nine, the Authority was forecasting an overspend of £0.5 million against the budget, a significant improvement from the £7.2 million overspend predicted at the end of the second quarter. This is primarily due to over £8 million of unbudgeted funding from the NHS to support the work in Adult and Children's social care services which has helped to offset continuing pressures in these areas. The Authority continues to experience declining income in areas such as car parking, planning fees and section 278 agreements, however this has been offset to some extent by savings of £3.3 million on budgeted finance costs. The 2011/12 budget included a savings programme totalling £90 million. The Authority reported that more than £80 million of the budgeted savings are on target to be achieved at period nine. All directorates were continuing to develop and implement action plans and the position was being closely monitored. *Continued overleaf*	The Authority's final outturn position was a £1.5 million underspend on budget. The main improvement from the period nine position relates to £2.1 million strategic net savings which were confirmed after year-end. Including, £1.6 million of interest costs were capitalised in respect of assets under construction. The Authority also received an additional £5.3 million as part of the New Homes Bonus scheme. These savings were partly offset by a further shortfall in Section 278 income of almost £1.1 million, the need to fund £1.3 million of PFI liabilities from the revenue budget due to a shortfall in budgeted capital receipts and the creation of a £1.2 million earmarked reserve in respect of MMI liabilities. A large part of the £90 million planned savings was achieved and the Authority also identified additional savings and secured unbudgeted (and recurring) income. This meant that despite slippages against some aspects of the original savings plan, the Authority was able to out-perform its original budget..

Critical accounting matters (continued)

Key audit risk	Issue raised during planning	Findings
	The Authority estimated that another £47 million in savings will need to be achieved during 2012/13 to address the further reductions to local authority funding. Against a backdrop of continued demand pressures in Adult Social Care and Children's Services it will become more and more difficult to deliver these savings in a way that secures longer term financial and operational sustainability. The Authority had established plans to further reduce its staff costs by implementing another round of its Early Leavers' Initiative (ELI) in 2011/12. Staff were expected to leave before 31st December 2011 which would enable the Authority to save three months of costs in the current financial year. Over 1,000 staff members put themselves forward for this programme although it was unlikely that all such requests will be accommodated due to the need to balance service delivery with cost savings. It was anticipated that a further round will be implemented in 2012/13.	The Authority budgeted to reduce staff costs by £45 million compared to 2010/11 and this was largely achieved, with just a £530,000 net overspend on pay costs at year-end. The Early Leavers' Initiative (ELI) continued to be successful in helping to control staff costs, with 636 full-time equivalents leaving under the scheme in the year. Other savings were achieved through the continued application of a recruitment freeze, the transfer of an element of the homecare service to an external provider and grant-related reductions in staffing. The overall net overspend of £530,000 on staffing was largely due to a £2.1 million overspend in the Environment and Neighbourhoods directorate which has been attributed to delays in the withdrawal of the refuse collection back-up service and the cost of staff in managing workforce change. These overspends were offset by significant savings in pay costs in Adult Social Care (over £600,000) and Children's Services (over £1.6 million). The remaining overspend was largely attributable to Legal Services. We have included an update on the future financial plans on page 14 of this report.

Critical accounting matters (continued)

Key audit risk	Issue raised during planning	Findings
	The Authority needed to continue to monitor the reasonableness and appropriateness of its componentisation policy in line with any guidance released by the Audit Commission or CIPFA. This is particularly important given the move to HRA self-financing from 2012/13 as depreciation becomes a charge to the HRA that will not be reversed. Where the depreciation charge without componentisation differs materially from that which would be charged if component accounting had been implemented, this will have a direct impact on the surplus/deficit reported. In 2010/11 the Authority elected not to apply component accounting to its HRA assets as it would not have had a material impact on the financial statements. We needed to gain assurance that this policy continues to be appropriate in 2011/12 and in light of any new guidance.	In 2010/11, the Authority undertook an exercise to identify any potentially significant components across both general fund and HRA buildings. 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. 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. In 2011/12 the Authority continues to apply the same approach to component accounting of HRA assets as in the prior year, whereby only the land and building elements are recognised separately. In order to demonstrate that this policy remained valid, the Authority reviewed a representative sample of HRA assets to establish if there were any significant components, their useful economic lives and replacement costs. The results of this exercise corroborated the findings from the 2010/11 exercise which concluded that, by electing not to implement component accounting for HRA assets, the resulting depreciation charge is not materially different. We reviewed the Authority's rationale for selecting the sample, its findings and conclusions. We are satisfied that the sample of HRA assets tested is reliable and representative of the HRA asset base as a whole and that the conclusions drawn are reasonable. The Authority will continue to consider the appropriateness of this policy going forwards and in light of any new guidance issued.

Critical accounting matters (continued)

Key audit risk	Issue	Findings
Code changes	The *2011/12 Code* includes a number of accounting changes, including a new requirement to carry 'heritage assets' at valuation. Heritage assets include historical buildings, museum and gallery collections and works of art. The Authority needs to review and appropriately address these changes in its 2011/12 financial statements.	We reviewed the Authority's process for identifying its heritage assets to gain assurance that this was reasonable. We found the approach undertaken to be comprehensive and in line with other authorities. Once the heritage assets had been identified, the Authority considered how to place a value on them and whether there was sufficient financial information available to recognise any value on the balance sheet in respect of those assets (in line with the *2011/12 Code*). For artworks and museum exhibits, the Authority has valued those individual assets with insurance valuations above £1 million at the insurance valuation. Lower value items which are included in the overall insurance valuation have not been recognised on the balance sheet as the cost to value each item individually was considered to be prohibitive. Items purchased during the last five years have been included at their original cost. Historic buildings have also been valued at historic cost where such information is available. As a result of this process, the Authority identified £46.7 million of heritage assets as at 31 March 2011. This is considered to be material to the financial statements, consequently the Authority has made a prior period restatement and produced a third, comparative, balance sheet for 2009/10. The value of heritage assets at 31 March 2012 is £50.8 million, largely as a result of upwards revaluations in year of £1.9 million and the grant-funded purchase of a museum artefact to the value of £2.1 million. We are satisfied that the Authority has complied with the requirements of the *2011/12 Code* in respect of heritage assets.

Accounts production and audit process

The quality of the accounts and the supporting workings papers remains high. Officers have provided working papers electronically, as requested, wherever possible.

Officers dealt efficiently with audit queries and the audit process is expected to be completed within the planned timescales.

The Authority has implemented all of the recommendations in our *ISA 260 Report 2010/11* relating to the financial statements.

Accounts production and audit process

ISA 260 requires us to communicate to you our views about the significant qualitative aspects of the Authority's accounting practices and financial reporting. We also assessed the Authority's process for preparing the accounts and its support for an efficient audit.

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority has a robust financial reporting process and we consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 3 July 2012, prior to the start of the audit on site and within the agreed timescales.
Quality of supporting working papers	Our *Accounts Audit Protocol*, which we issued in June, set out our working paper requirements for the audit. The quality of working papers provided was excellent and met the standards specified in our *Accounts Audit Protocol*.
Response to audit queries	In general, officers resolved our audit queries in a reasonable time.
Group audit	To gain assurance over the Authority's group accounts, we will place reliance on work completed by BDO on the financial statements of Aire Valley Homes Leeds Limited, East/North East Homes Leeds Limited and West North West Homes Leeds Limited. There are no specific matters to report pertaining to the group audit.

Prior year recommendations

In our *Interim Audit Report 2011/12* we commented on the Authority's progress in addressing the recommendations in our *ISA 260 Report 2010/11.*

The Authority has now implemented all of the recommendations in our *ISA 260 Report 2010/11* relating to the financial statements.

Appendix 2 provides further details.

Completion

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

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

Once we have finalised our opinions and conclusions we will prepare our *Annual Audit Letter* and close our audit.

Declaration of independence and objectivity

As part of the finalisation process we are required to provide you with representations concerning our independence.

In relation to the audit of the financial statements of Leeds City Council for the year ending 31 March 2012, 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 4 in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Principal Accountant, Corporate Financial Management, a draft of which is reproduced in Appendix 5. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

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

- significant difficulties encountered during the audit;
- significant matters arising from the audit that were discussed, or subject to correspondence with management;
- other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process; and
- matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. significant deficiencies in internal control; issues relating to fraud, compliance with laws and regulations, subsequent events etc.).

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority's 2011/12 financial statements.

VFM conclusion

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

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

Background

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

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

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

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

Conclusion

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

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

We reported our risk assessment in our *Interim Audit Report 2011/12*. The following pages include further details on our specific risk-based work.

Specific VFM risks

We have now concluded our specific work in relation to the residual risks we set out in our *Interim Audit Report 2011/12.*

In our *Interim Audit Report 2011/12* we identified the residual audit risks for our VFM conclusion, and set out our preliminary assessment of these with reference to the relevant work by the Authority, the Audit Commission, other inspectorates and review agencies.

We concluded that we needed to carry out additional work for some of these risks and this work is now complete.

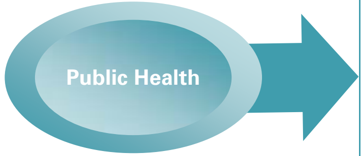
The outcome of this work is set out below.

Key VFM risk	Preliminary assessment	Key findings of our additional work
Financial standing – savings plans	*Risk* The Authority needed to deliver significant savings during 2011/12 to achieve its balanced budget. Government funding in 2011/12 has been reduced by £50 million and the Authority forecasts that there will be a real terms reduction in grants available of £179 million by 2014/15. The Authority estimates that another £47 million in savings will need to be achieved during 2012/13 to address the further reductions to funding. Against a backdrop of continued demand pressures in Adult Social Care and Children's Services it will become more and more difficult to deliver these savings in a way that secures longer term financial and operational sustainability. The Authority has plans to deliver another round of its Early Leavers' Initiative in 2012/13 which will enable it to deliver some of the required savings. However, with continuing cuts to staff numbers, the Authority needs to ensure that it carefully balances service delivery with cost savings. *Continued overleaf*	As noted in the previous section, the Authority largely achieved its planned £90 million savings in 2011/12 and was under spent on its revenue budget by £1.5 million. The Authority monitors its revenue budget on a monthly basis and the latest Medium Term Financial Plan (MTFP) will to take into consideration the potential further funding reductions. The latest MTFP is expected to be finalised in December 2012. The ELI has resulted in over 600 full-time equivalent staff departing the Authority during 2011/12. The Authority has a track record of delivering a balanced budget and has again set a balanced budget for 2012/13. The Authority is also ensuring that it is aware of and planning for coming changes, such as business rate and welfare benefit reforms. These are likely to have a significant financial impact. In addition, the Authority is now looking at how it can continue to improve its efficiency so that it delivers further savings. This is to aid preparations for the forthcoming comprehensive spending review.

Specific VFM risks (continued)

Key VFM risk	Preliminary assessment	Key findings of our additional work
	The Authority needs to establish and manage its savings plans so as to secure longer term financial and operational sustainability. *Interim update* As noted in the previous section, the Authority achieved its planned £90 million savings in 2011/12 and was under spent on its revenue budget by £1.5 million. The Authority needs to continue to closely monitor its Medium Term Financial Plan and manage its financial pressures as the 2011/12 under spend is largely due to unbudgeted income of £6 million from the Department of Health and unbudgeted savings on debt costs which collectively had a +£11.1 million impact overall. The next steps of our work will involve critically assessing the controls the Authority has in place to ensure a sound financial standing, specifically that its Medium Term Financial Plan has duly taken into consideration the potential further funding reductions. It should be sufficiently robust to ensure that the Authority can continue to provide services effectively. We will also review what impact, if any, the ELI has had on service quality.	

Specific VFM risks (continued)

Key VFM risk	Preliminary assessment	Key findings of our additional work
	*Risk* Leeds City Council is acquiring the responsibility for public health services from Leeds Primary Care Trust. This transfer brings about several risks that will need to be managed carefully by the Authority, including: • financial risks from the delivery of a new, less familiar service; • how the service fits strategically and operationally within the Authority; • ensuring that clinical governance requirements are met. This is relevant to both the financial resilience and economy, efficiency and effectiveness criteria of the VFM conclusion. *Interim update* We have held initial discussions with the Authority's management and KPMG's health specialists around what the key risks of the transfer are and how the Authority plans to deal with this. The Authority is currently in the process of establishing the appropriate structures to support the delivery of public health services and has a joint appointment with the Primary Care Trust for the Director of the service who is overseeing the transition. *Continued overleaf*	We have held an initial meeting with the joint Director of Public Health. This provided evidence that the Authority is aware of the plans, risks and actions it will need to put in place in preparation for the transfer of public health services to the Authority from April 2013. Reports have been taken to the Executive regarding the Authority's new responsibilities in respect of public health and its progress towards the transfer. We will continue to monitor the Authority's progress in relation to this transfer over the next six months to ensure that plans are on track.

Specific VFM risks (continued)

Key VFM risk	Preliminary assessment	Key findings of our additional work
	We have agreed to facilitate a workshop to aid the discussions around the key risks of the transfer and associated actions. The workshop is likely to involve the Executive management of the Authority and other key stakeholders determined by the joint Director of Public Health.	

Appendix 1: Key issues and recommendations

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

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

We will formally follow up these recommendations next year.

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

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
1	❷	**Incorrect cut off for fixed asset disposals** Our testing of fixed asset disposals identified that a school had transferred to Academy status after year-end but had been accounted for as a disposal during 2011/12. The transfer had been due to take place before 31 March 2012 but was delayed due to clerical errors within the School when completing the transfer documentation. Corporate Financial Management only became aware of this when we requested audit evidence of the transfer. Corporate Financial Management should ensure that any transfers of schools to Academies are supported by the relevant legal documents to ensure that the disposal is recorded in the correct financial period.	Agreed. Year end procedures will be amended so that appropriate documentation is obtained prior to the accounts being approved in order to evidence the transfer has taken place within the financial year. Action: Principal accountant Corporate Financial Management Date: March 2013

Appendix 1: Key issues and recommendations (continued)

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
2	❸	**Quality assurance processes over heritage asset values** The value of one of the heritage assets selected for testing in the accounts did not agree to the supporting evidence. This is considered to be a data input error and the difference of £200,000 was clearly trivial, however there were no internal procedures in place to verify that the asset valuations provided by the relevant department to Corporate Financial Management were correct and the difference could have been material. Appropriate quality assurance procedures should be implemented to ensure that heritage asset valuations are agreed to relevant supporting evidence prior to inclusion in the financial statements. It should be noted that the value of the heritage asset in question is expected to be adjusted in the final financial statements.	Agreed. Year end procedures will be amended so that appropriate documentation is obtained to evidence new or amended valuations in respect of Heritage Assets. Action: Principal accountant Corporate Financial Management Date: March 2013

Appendix 2: Follow up of prior year recommendations

The Authority has implemented all of the recommendations in our *ISA 260 Report 2010/11.*

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2010/11* and re-iterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	2
Implemented in year or superseded	2
Remain outstanding (re-iterated below)	0

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2012
1	2	**Medium Term Financial Plan** 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. However, the scale of the challenge ahead is not to be underestimated and key to this will be managing the overspends in Adults and Children's which, as at month 4 of 2011/12, are showing overspends of £10.6m. The Authority need to ensure that they continually monitor their Medium Term Financial Plan and take appropriate early interventions to manage their financial pressures.	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. **Responsible officer: Chief Officer Financial Management** **Due date: February 2012**	We identified the Authority's financial standing as a critical accounting matter and a key VFM risk in the *External Audit Plan 2011/12*, presented to you in February 2012. Our detailed audit response to this key risk has been set out in the previous section. We are satisfied that the Authority monitors the revenue budget on a monthly basis via the Executive Board, having reviewed the reports as part of our audit work.

Appendix 2: Follow up of prior year recommendations (continued)

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2012
2	2	**Component Accounting** 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. 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. *Continued overleaf.*	The council will review all capital spend at the end of each year under its established accounting policy for components. **Responsible officer: Principal accountant Corporate Financial Management.** **Implementation date: closedown 2011/12.** 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: Principal accountant Corporate Financial Management.** **Implementation date: As and when accounting standards are amended**.	We identified component accounting as a critical accounting matter in the *External Audit Plan 2011/12*, presented to you in February 2012. Our detailed audit response to this key risk has been set out on page nine in section three to this report. We are satisfied with the Authority's approach to component accounting for 2011/12 and its decision not to apply component accounting to its HRA assets (other than by recognising land and buildings separately). We have confirmed that the Authority will continued to consider the appropriateness of this policy going forwards and in light of any new guidance issued.

Appendix 2: Follow up of prior year recommendations (continued)

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2012
2	2	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. 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: *Continued overleaf.*		

Appendix 2: Follow up of prior year recommendations (continued)

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2012
2	2	•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.		

Appendix 3: Audit differences

This appendix sets out the significant audit differences. We have only identified one such audit difference during the course of the audit. It is our understanding that this will be adjusted.

The audit difference relates to the transfer of a school to Academy status. The deemed disposal was accounted for in 2011/12 but due to administrative errors on the legal paperwork, the transfer was delayed until after year-end and as such, should be accounted for in 2012/13.

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 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 2012. It is our understanding that this will be adjusted. However, we have not yet received a revised set of financial statements to confirm this.

	Impact					
No.	**Income and Expenditure Statement**	**Movement in Reserves Statement**	**Assets**	**Liabilities**	**Reserves**	**Basis of audit difference**
1	*Cr Loss on disposal of fixed assets* £16.6 million	*Cr Statutory adjustments between accounting and funding basis* £16.6 million	*Dr Property, plant and equipment* £16.6 million		*Cr Capital Adjustment Account* £11.5 million *Cr Revaluation Reserve* £5.1 million	The Authority accounted for disposal in 2011/12 of a school which was transferring to Academy status. However, the transfer actually took place after year-end.
	Cr £16.6 million	**Dr £16.6 million**	**Dr £16.6 million**	**Dr/Cr £0**	**Cr £16.6 million**	**Total impact of adjustments**

Appendix 4: 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. We do this in our Annual Audit Letter.

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from his. These matters should be discussed with the Corporate Governance and Audit Committee.

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

General procedures to safeguard independence and objectivity

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

Appendix 4: Declaration of independence and objectivity (continued)

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

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

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

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

Auditor declaration

In relation to the audit of the financial statements of Leeds City Council for the financial year ending 31 March 2012, 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.

Appendix 5: Draft management representation letter

We ask you to provide us with representations on specific matters such as whether the transactions within the accounts are legal and unaffected by fraud.

The wording for these representations is prescribed by auditing standards.

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

Dear Sirs

This representation letter is provided in connection with your audit of the Leeds City Council and Group financial statements, for the year ended 31 March 2012, for the purpose of expressing an opinion as to whether these:

i. give a true and fair view of the financial position of Leeds City Council and its Group as at 31 March 2012 and of its income and expenditure for the year then ended; and

ii. have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

These financial statements comprise the Authority and Group Movement in Reserves Statement, the Authority and Group Comprehensive Income and Expenditure Statement, the Authority and Group Balance Sheet, the Authority and Group Cash Flow Statement[, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement and the Collection Fund and the related notes

The Authority confirms that the representations it makes in this letter are in accordance with the definitions set out in the Appendix to this letter.

The Authority confirms that, to the best of its knowledge and belief, having made such inquiries as it considered necessary for the purpose of appropriately informing itself:

Financial statements

1. The Authority has fulfilled its responsibilities, as set out in regulation 8 of the Accounts and Audit (England) Regulations 2011, for the preparation of financial statements that:
   - give a true and fair view of the financial position of Leeds City Council and its Group as at 31 March 2012 and of its income and expenditure for the year then ended;
   - have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

   The financial statements have been prepared on a going concern basis.
2. Measurement methods and significant assumptions used by the Authority in making accounting estimates, including those measured at fair value, are reasonable.
3. All events subsequent to the date of the financial statements and for which the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom require adjustment or disclosure have been adjusted or disclosed.
4. In respect of the restatement for heritage assets made to correct a material misstatement in the prior period financial statements, the Authority confirms that the restatement is appropriate.

Information provided

5. The Authority has provided you with:
   - access to all information of which it is aware, that is relevant to the preparation of the financial statements, such as records, documentation and other matters;
   - additional information that you have requested from the Authority for the purpose of the audit; and
   - unrestricted access to persons within the Authority and Group from whom you determined it necessary to obtain audit evidence.
6. All transactions have been recorded in the accounting records and are reflected in the financial statements.

Appendix 5: Draft management representation letter

We ask you to provide us with representations on specific matters such as whether the transactions within the accounts are legal and unaffected by fraud.

The wording for these representations is prescribed by auditing standards.

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

7. The Authority acknowledges its responsibility for such internal control as it determines necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In particular, the Authority acknowledges its responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

8. The Authority has disclosed to you the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

9. The Authority has disclosed to you all information in relation to:

a) Fraud or suspected fraud that it is aware of and that affects the Authority and its Group and involves:

- management;
- employees who have significant roles in internal control; or
- others where the fraud could have a material effect on the financial statements; and

b) allegations of fraud, or suspected fraud, affecting the Authority and Group financial statements communicated by employees, former employees, analysts, regulators or others.

10. The Authority has disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements. Further, the Authority has disclosed to you and has appropriately accounted for and/or disclosed in the financial statements in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.

11. On the basis of the process established by the Authority and having made appropriate enquiries, the Authority is satisfied that the actuarial assumptions underlying the valuation of pension scheme liabilities are consistent with its knowledge of the business.

12. The Authority further confirms that:

a) all significant retirement benefits, including any arrangements that:

- are statutory, contractual or implicit in the employer's actions;
- arise in the UK and the Republic of Ireland or overseas;
- are funded or unfunded; and
- are approved or unapproved,

have been identified and properly accounted for; and

b) all settlements and curtailments have been identified and properly accounted for.

This letter was tabled and agreed at the meeting of the Corporate Governance and Audit Committee on 28 September 2012.

Yours faithfully,

[Chair of the Audit Committee] , [Chief Financial Officer] cutting through complexity™