KPMG

cutting through complexity

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

Leicester City Council

18 September 2015

# 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 issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

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

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact John Cornett, the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Trevor Rees (on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk). After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

Section one

# Introduction

**This document summarises:**

- **the key issues identified during our audit of the financial statements for the year ended 31 March 2015 for the Authority; and**
- **our assessment of the Authority's arrangements to secure value for money.**

## Scope of this report

This report summarises the key findings arising from:

- our audit work at Leicester City Council ('the Authority') in relation to the Authority's 2014/15 financial statements; and
- the work to support our 2014/15 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

## Financial statements

Our *External Audit Plan 2014/15*, presented to you in March 2015, set out the four stages of our financial statements audit process.


This report focuses on the third stage of the process: substantive procedures. Our on site work for this took place during February 2015 (interim audit) and August/September 2015.

We are now in the final phase of the audit, the completion stage. Some aspects of this stage are also discharged through this report.

## VFM conclusion

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

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

## Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our audit work in relation to the 2014/15 financial statements of the Authority.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1 with our follow up of previous year recommendations 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 the headline messages for the Authority. The remainder of this report provides further details on each area.**

| | |
|---|---|
| **Proposed audit opinion** | We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2015. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007. |
| **Audit adjustments** | Our audit identified the following adjustments affecting the primary statements:<br>■ Two investments totalling £10 million have been reclassified from 'Cash and cash equivalents' to 'Short term investments';<br>■ 'Cash and Cash Equivalents', and 'Bank overdraft' have both been increased by £22.4 million on the Balance Sheet. This is purely a presentational matter: the net amount of cash equivalents at the end of the reporting period has not been changed; and<br>■ 'Adjustments for non-cash movements' and 'Adjustments for items that are investing or financing activities' have both been increased by £6.8 million in the Cash flow statement.<br>The Authority intends to adjust the value of schools and leisure centres by £76.5 million from the values disclosed in the draft statements, as indexation had not been applied since the date of the last formal valuation. Appendix 3 shows the adjustments that are to be made to the financial statements to reflect the current value of schools and leisure centres but overall there is no impact on the General Fund balance.<br>In addition, the Authority made a number of non-trivial adjustments to notes, most of which were of a presentational nature.<br>We understand that the financial statements will be amended for all of the errors identified through the audit process. However, we have not yet received a revised set of financial statements to confirm that all mis-statements have been amended.<br>There is no impact on the General Fund balance as a result of any of the above adjustments. However there is also a late adjustment being made to transfer £34 million from the general fund into earmarked reserves. |
| **Key financial statements audit risks** | We identified the following key financial statements audit risks in our 2014/15 External audit plan issued in March 2015.<br>■ Accounting for Local Authority Maintained Schools. CIPFA have issued definitive clarification of existing guidance on significant entries to be included in the financial statements; and<br>■ The in-year change of banking services provider from Co-op to Barclays. The Authority will need to ensure the accurate transfer of balances and update of financial systems to reflect this change.<br>We have worked with officers throughout the year to discuss these key risks and our detailed findings are reported in section 3 of this report. There are no matters of any significance arising as a result of our audit work in these key risk areas. |
| **Accounts production and audit process** | The Authority has satisfactory processes in place for the production of the accounts. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales. |

# Headlines (continued)

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

| | |
|---|---|
| **Completion** | At the date of this report our audit of the financial statements is substantially complete subject to finalisation of our work on payroll.<br>Before we can issue our opinion we require a signed management representation letter.<br>We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements. |
| **VFM conclusion and risk areas** | We did not identify any VFM risks in our External audit plan 2014/15. After we finalised our plan, an OFSTED report was published in March 2015 that concluded "The overall judgement is that children's services are inadequate."<br>We have worked with officers to discuss this VFM risk. The Authority has an improvement plan in place to address OFSTED's findings but procedures have yet to be fully embedded. Our detailed findings are reported in section 4 of this report.<br>We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources except for arrangements regarding children's services. We therefore anticipate issuing a qualified 'except for' VFM conclusion by 30 September 2015. |

# Financial Statements
# Proposed opinion and audit differences

**The Authority intends to adjust the value of schools and leisure centres from the values disclosed in the draft statements by £76.5 million.**

**There is also a late adjustment being made to transfer £34 million from the general fund into earmarked reserves.**

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

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

### Proposed audit opinion

We anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Audit and Risk Committee on 29 September 2015.

### Audit differences

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

The final materiality (see Appendix 5 for more information on materiality) level for this year's audit was set at £20 million. Audit differences below £1 million are not considered significant.

Officers have agreed to increase the value of schools and leisure centres by £56 million and £20 million respectively. Overall there is no impact on the General Fund Balance.

We understand there is also to be a late transfer of £34 million from the general fund into earmarked reserves.

We identified a 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 2014/15 ('the Code')*. These have been discussed with management and we understand that the financial statements will be amended for all of them. Further details are given in Appendix 3.

### Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

- it complies with *Delivering Good Governance in Local Government: A Framework* published by CIPFA/SOLACE; and
- it is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

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

In our *External Audit Plan 2014/15* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. These risk areas were Management override of controls and the Fraud risk of revenue recognition.

The table below sets out the outcome of our audit procedures and assessment on these risk areas.

| Areas of significant risk | | Summary of findings |
|---|---|---|
| **Management override of controls** | Audit areas affected<br>■ All areas | Our audit methodology incorporates the risk of management override as a default significant risk. Management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We have not identified any specific additional risks of management override relating to this audit.<br><br>In line with our methodology, we carried out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.<br><br>There are no matters arising from this work that we need to bring to your attention. |
| **Fraud risk of revenue recognition** | Audit areas affected<br>■ None | Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.<br><br>In our External Audit Plan 2014/15 we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue.<br><br>This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work. |

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

**We have worked with the Authority throughout the year to discuss significant risks and key areas of audit focus.**

**This section sets out our detailed findings on those risks.**

In our *External Audit Plan 2014/15*, presented to you in March 2015, we identified the significant risks affecting the Authority's 2014/15 financial statements. We have now completed our testing of these areas and set out below our evaluation following our substantive work.

| Significant audit risk | Issue | Findings |
|---|---|---|
| <br>**Audit areas affected**<br>▪ Property, plant & equipment<br>▪ CIES (Income/ Expenditure | LAAP Bulletin 101 *Accounting for School Assets used by Local Authority Maintained Schools* was issued in December 2014 to assist practitioners with the application of the Code in this respect. The challenges relate to school assets owned by third parties such as church bodies and made available to school governing bodies under a variety of arrangements. This includes assets used by Voluntary-Aided (VA) and Voluntary-Controlled (VC) Schools as well as Foundation Schools.<br>The agreements under which assets are used by VA/VC and Foundation schools and the relevant tests of control in the case of assets made available free of charge, or risks and rewards of ownership in the case of assets made available under leases, is a key area of judgement and there is a risk that the Authority could incorrectly omit school assets from, or include school assets in, their balance sheet.<br>Particular risks surround the recognition of Foundation School assets which may or may not be held in Trust. The Authority should pay particular attention to the nature of the relationship between the Trustees and the school governing body to determine whether the school controls the Trust and the assets should therefore be consolidated into the balance sheet. | We undertook the following work over the accounting for Local Authority Maintained Schools:<br>- Determined whether the Authority has identified all relevant maintained schools within its area and reviewed the agreements underpinning the use of school assets by VA, VC and Foundation schools; and<br>- Considered the Authority's application of the relevant accounting standards to account for these schools and challenged its judgements where necessary.<br>As a result of the Authority's own review of their accounting treatment of schools, two schools were identified as needing to be removed from the balance sheet. However these schools were still included within the draft statement of accounts, but have now been removed as part of the agreed audit adjustments to PPE. |

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

**We have worked with the Authority throughout the year to discuss significant risks and key areas of audit focus.**

**This section sets out our detailed findings on those risks.**

| Significant audit risk | Issue | Findings |
|---|---|---|
| **Change of Banks**<br><br>**Audit areas affected**<br>■ Financial Statements | The Authority began transferring banking services from Co-op to Barclays in February 2015. This represents a significant change to how banking transactions are set up and processed. There is a risk that:<br>• bank balances have not been accurately transferred to Barclays; and<br>• amounts that were credited directly to the Co-op bank account by third parties are not received in the Barclays accounts | We reviewed the Authority's arrangements for ensuring the accurate transfer of bank balances, amending the general ledger and ensuring completeness of income to reflect the change in bank provider.<br><br>There are no issues arising from our work to date that we need to report to the Authority. |

# Financial Statements (continued)
# Accounts production and audit process

**The Authority has satisfactory processes in place for the production of the accounts and good quality working papers. However the Authority's quality review of the draft financial statements can be improved.**

**Officers dealt promptly and efficiently with audit queries and the audit process was completed within the planned timescales.**

## 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 criteria shown in the table opposite.

## Findings in respect of the control environment for key financial systems

During February 2015 we completed our control evaluation work as part of our interim audit visit. We found that, while monthly bank reconciliations had been carried out, there was no evidence of review of the reconciliations. Also on one reconciliation there was no evidence that a small reconciling item had been investigated and resolved. These matters have now been addressed and we have no further matters to report following our review of the year end bank reconciliation.

We also identified that periodic circularisation of establishment lists to Chief Officers were not returned in all instances. The benefit of comparing establishment lists with detailed amounts charged against budgets is to help identify any inappropriate charges to budgets. In order to avoid duplication of effort, and to promote a more efficient way of providing assurance to management, we informed Internal Audit who were about to undertake a payroll review. As Internal Audit included a recommendation in their payroll report issued in August 2015, we have not made a separate recommendation in this report.

## Prior year recommendations

The Authority has not fully implemented the recommendations in our *ISA 260 Report 2013/14*. Details are included in Appendix 2.

| Element | Commentary |
|---|---|
| **Accounting practices and financial reporting** | The Authority has satisfactory financial reporting arrangements in place.<br><br>We consider that accounting practices are appropriate. |
| **Completeness and quality of draft accounts** | We received a complete set of draft accounts on 1 July 2015. However there are late changes that are to be made to the draft statements, notably to the value of PPE and to earmarked reserves.<br><br>Also, our audit has identified a number of adjustments that are required, including amendments to the CIES, Balance Sheet, MIRS and notes to the accounts. Details of these adjustments are set out in Appendix 3.<br><br>We have raised a recommendation in respect of the Authority's quality review of the accounts and notes which is included in Appendix 1. |
| **Quality of supporting working papers** | We discussed our Accounts Audit Protocol including our required working papers for the audit with the corporate finance team in February 2015.<br><br>The quality of working papers provided met the standards specified in our *Accounts Audit Protocol*. |
| **Response to audit queries** | Officers resolved all audit queries in a timely manner. |

# Financial Statements (continued)

## Completion

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

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

**Once we have finalised our opinion and conclusion 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 Leicester City Council for the year ended 31 March 2015, we confirm that there were no relationships between KPMG LLP and Leicester 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 Public Sector Audit Appointments Ltd 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 Director of Corporate Services for presentation to the Audit and Risk Committee. We require a signed copy of your management representations before we issue our audit opinion.

### Other matters

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

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

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report.

# 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 except for arrangements regarding children's services.**

## Background

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

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

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

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

## Work completed

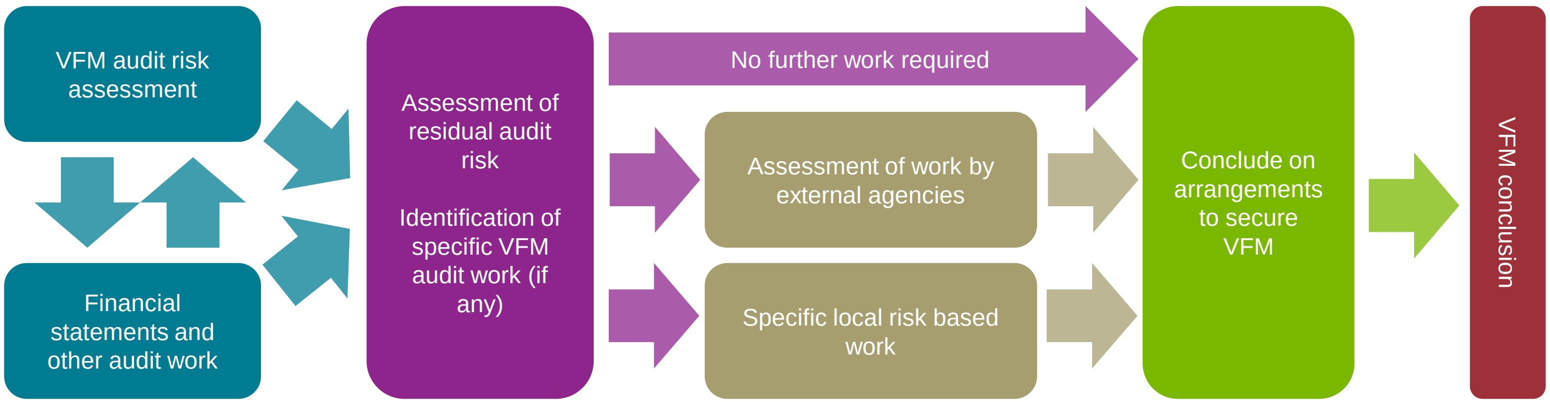
We did not identify any VFM risks in our External audit plan 2014/15. After we finalised our plan, an OFSTED report was published in March 2015 that concluded "The overall judgement is that children's services are inadequate."

The following page includes further details of our VFM risk assessment and our specific risk-based work.

## Conclusion

We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources except for arrangements regarding children's services.

| VFM criterion | Met |
|---|---|
| **Securing financial resilience** | ✓ |
| **Securing economy, efficiency and effectiveness** | x |



# Specific VFM risks

**We have identified a specific VFM risk regarding childrens' services.**

**The Authority has an improvement plan in place to address OFSTED's findings but procedures have yet to be fully embedded.**

## Work completed

In line with the risk-based approach set out on the previous page, we have:

- assessed the Authority's key business risks which are relevant to our VFM conclusion;
- identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;
- considered the results of relevant work by the Authority, inspectorates and review agencies in relation to these risk areas; and
- completed specific local risk based work.

## Key findings

Below we set out the findings in respect of those areas where we have identified a residual audit risk for our VFM conclusion.

We concluded that we needed to carry out additional work. This work is now complete and we report on this below.

| Key VFM risk | Risk description and link to VFM conclusion | Assessment |
|---|---|---|
|   | In March 2015 OFSTED published a report "Inspection of services for children in need of help and protection, children looked after and care leavers and Review of the effectiveness of the local safeguarding children board". The OFTSED overall judgement was that children's services are inadequate.<br><br>The service is a significant part of the Authority's activities. Net expenditure is around £50m pa.<br><br>Taking these factors together, it is likely that there are weaknesses in the Authority's arrangements for providing value for money.<br><br>This is relevant to the economy, efficiency and effectiveness criterion of the VFM conclusion. | The OFSTED report included 24 recommendations addressed to the Authority. A two year time frame has been set for re-inspection of the service, to allow the Authority time to embed improved processes.<br><br>**Specific risk based work required: Yes**<br><br>From our review of documentation and discussions with officers, we are satisfied that the Authority has drawn up an Improvement Plan which sets out detailed actions in response to all the OFSTED recommendations.<br><br>Due to the short time period since the receipt of the OFSTED report, only two recommendations have been fully addressed to date and procedures have yet to be fully embedded. Therefore at this stage we cannot comment on whether the Plan will be delivered within the required timescale.<br><br>We also do not form any judgement as to the qualitative aspects of the Improvement Plan ie whether the actions, when implemented, will lead to an improved childrens' service. |

# 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 |
|---|---|---|---|
| 1 | ❷ | **Notes to the Financial Statements**<br>Non-trivial amendments have been made to a number of notes in the financial statements. These were mainly of a presentational nature. More detail is given in Appendix 3.<br>The notes form part of the statements by giving details about entries in the primary statements. It is therefore important that the entries in the notes are fairly stated.<br>**Recommendation**<br>Ensure the 2015/16 accounts closedown timetable includes a robust quality review of the notes. | Management accept this recommendation. A plan of work to deliver this objective is in place.<br><br>Principal Accountant – Corporate Accountancy |

# Appendix 2: Follow up of prior year recommendations

**The Authority has not fully implemented all of the recommendations in our *ISA 260 Report 2013/14.***

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2013/14* and re-iterates any recommendations still outstanding.

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

| No. | Risk | Issue and recommendation | Management response/ responsible officer in ISA Report 2013/14 | Status as at September 2015 |
|---|---|---|---|---|
| 1 | 2 | **Related party disclosure:**<br><br>Assurance about related party transactions relates to the year of account and it is important that declarations are received from all members in position for that year.<br><br>Last year we reported that related party declarations had not been returned by three councillors, with the impact that there may be significant matters undisclosed. For 2013/14, six councillors did not return their annual declarations.<br><br>**Recommendation**<br><br>Publish the names of members who fail to return related party declarations. The Chair of the Audit and Risk Committee may wish to consider what further actions are available. | **Principal Accountant – Corporate Accountancy (comments):**<br><br>We have continued to make efforts to secure a return from all members, including making it possible to respond via email and providing improved guidance notes. | For 2014/15, 10 councilors did not return their annual declarations.<br>• Six were individuals who ceased to be members of the Authority at the elections in May 2015; and<br>• Four were individuals who continued to be members of the Authority after the elections in May 2015.<br><br>In respect of all but two of the individuals who ceased to be members of the Authority at the elections in May 2015 we have examined the online records of declarations of interests. We have not identified any matters that we consider should have been disclosed in the notes to the financial statements.<br><br>**Management response**<br><br>Management feel that the response to this recommendation is a matter for the Audit & Risk Committee but is able to support any action the Committee may feel it appropriate to take. |

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

**The Authority has not fully implemented all of the recommendations in our *ISA 260 Report 2013/14***

| No. | Risk | Issue and recommendation | Management response/ responsible officer in ISA Report 2013/14 | Status as at September 2015 |
|---|---|---|---|---|
| 2 | 2 | **Journal controls:**<br>For the last two years we reported that although only authorised finance staff can raise journals, and that there is a degree of authorisation through granting appropriate permissions when staff take up posts, there is no check that journals processed are complete or accurate.<br><br>Our recommendation was to produce a report of non-routine journals raised by finance staff, and provide evidence that journals are authorised by a senior member of the finance team. This was agreed by officers. | **Principal Accountant – Corporate Accountancy (comments):**<br><br>We have developed a report that allows managers to review journals containing items over a given threshold. This has been publicised/demonstrated at the department's Principal Accountants Group. At present, we have left this control to Principal Accountants to use as they see best. The report has been used corporately to review year end items in Period 14. Requirements around this will be reviewed again during 2014/15 to determine if further procedures should be put in place. | There is still no established process for authorising journals.<br>**Management response**<br>The longer-term solution to this issue will be a system-based authorisation workflow process – in order to meet the recommendation, we are including this in our specification of needs from the Council's future finance system, for which a procurement exercise is currently underway. Prior to the introduction of a new system, a number of options have been identified for controlling journals, which will be presented to the Finance Management Team. Any additional controls adopted will be incorporated into the Council's processes and rules as required. |

# Appendix 3: Audit differences

**This appendix sets out the audit differences.**

**We understand that the financial statements will be amended for all of the mis-statements and adjustments identified through the audit process.**

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 your case is the Audit and Risk 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.

## Uncorrected audit differences

We are pleased to report that there are no uncorrected audit differences. However, we have not yet received a revised set of financial statements to confirm that all mis-statements have been amended.

## Corrected audit differences

**Material misstatements affecting the primary financial statements**

A review of schools and leisure centre balances held in the fixed asset register indicated that these had been understated as indexation had not been applied since the date of the last formal valuation (this will have taken place within the last 5 years in accordance with the Authority's rolling programme of revaluations). The value of schools had been understated by £55.8 million and the value of leisure centres had been understated by £20.7 million. As shown in the table below, there are a number of adjustments required to be made to the financial statements to reflect the current value of schools and leisure centres but overall there is no impact on the General Fund balance.

The adjustments below include the removal of two schools from the Balance Sheet in accordance with the guidance issued in LAAP Bulletin 101.

| Valuation of schools and leisure centres | Impact £000 | | | |
|---|---|---|---|---|
| | Income and Expenditure Statement: reduction in cost of services | Movement in Reserves Statement | Increase in Assets | Increase in Unuseable Reserves |
| Increase in PPE balances | | | 76,538 | |
| Reversal of prior year impairments:<br>Education and childrens services<br>Cultural and related services | <br>(26,216)<br>(6,772) | | | |
| Increase in revaluation reserve | | | | (43,550 |
| Transfer to the Capital Adjustment Account for statutory purposes | | 32,988 | | (32,988) |
| **Total impact of adjustments** | **(32,988)** | **32,988** | **76,538** | **(76,538)** |

# Appendix 3: Audit differences (continued)

**This appendix sets out the audit differences.**

**We understand that the financial statements will be amended for all of the mis-statements and adjustments identified through the audit process.**

**Material misstatements affecting the primary financial statements (continued)**

The presentation of bank balances and overdrafts is determined by whether there are rights of set off between accounts. Accounts that are 'in credit' at the bank and accounts that are overdrawn can be netted of in the Balance Sheet if there is a legal right of set off agreed with the bank. We identified some bank balances that had not been correctly presented. Officers have agreed to increase both 'Cash and Cash Equivalents' and 'Bank overdraft' by £22.4 million on the Balance Sheet. This is purely a presentational matter: the net amount of cash equivalents at the end of the reporting period has not been changed.

There is also a late adjustment being made to transfer £34 million from the general fund into earmarked reserves.

**Other mis-statements and adjustments**

*Balance sheet*

Two investments totalling £10 million have been reclassified from 'Cash and cash equivalents' to 'Short term investments' as they were both of more than three months' duration and the classification in the draft statements therefore did not comply with the Authority's accounting policy.

*Cash flow statement*

After producing the draft statements, officers identified the need to increase 'Adjustments for non-cash movements' and 'Adjustments for items that are investing or financing activities' by £6.8 million.

*Notes to the financial statements*

Our audit also identified a number of disclosure errors affecting notes to the financial statements. These have been discussed with management and the financial statements will be amended for all of them. The main notes amended were:

- Note 7 'Adjustments between Accounting basis and Funding basis under Regulations' and Note 24 'Unusable Reserves (Capital Adjustment Account): comparatives (ie 2013/14 entries) for 'Capital grants and contributions applied' and 'Revenue expenditure funded from capital under statute' both increased by £36.0 million in order to present information consistently with 2014/15;
- Note 23 'Useable Reserves': no change to the total but the movements and closing balances for each reserve did not agree to the Movement in Reserves Statement;
- Note 28 'Amounts Reported for Resource Allocation Decisions': some of the entries have been amended by material amounts in order for the note to be presented consistently with the previous year and to agree to the Income and expenditure Account;

*Accounting policies*

Following the guidance issued in LAAP Bulletin 101, officers have agreed to amend the accounting policy in respect of schools.

# Appendix 4: Declaration of independence and objectivity

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

## Requirements

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

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

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Public Sector Audit Appointments Ltd *Terms of Appointment* ('Public Sector Audit Appointments Ltd Guidance') and the requirements of APB Ethical Standard 1 *Integrity, Objectivity and Independence* ('Ethical Standards').

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

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

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

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

## General procedures to safeguard independence and objectivity

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

# 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 Leicester City Council for the financial year ended 31 March 2015, we confirm that there were no relationships between KPMG LLP and Leicester City Council Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

# Appendix 5: Materiality and reporting of audit differences

**For 2014/15 our materiality is £20 million for the Authority's accounts.**

**We have reported all audit differences over £1 million for the Authority's accounts to the Audit and Risk Committee.**

## Materiality

The assessment of what is material is a matter of professional judgment and includes consideration of three aspects: materiality by value, nature and context.

- Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.
- Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.
- Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We used the same planning materiality reported in our External Audit Plan 2014/15, presented to you in March 2015.

Materiality for the Authority's accounts was set at £20 million which equates to around 2 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

## Reporting to the Audit and Risk Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit and Risk Committee any misstatements of lesser amounts to the extent that these are identified by our audit work.

Under ISA 260, we are obliged to report omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

ISA 450 requires us to request that uncorrected misstatements are corrected.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £1 million for the Authority.

Where management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit and Risk Committee to assist it in fulfilling its governance responsibilities.

# Appendix 6: KPMG Audit Quality Framework

**We continually focus on delivering a high quality audit.**

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

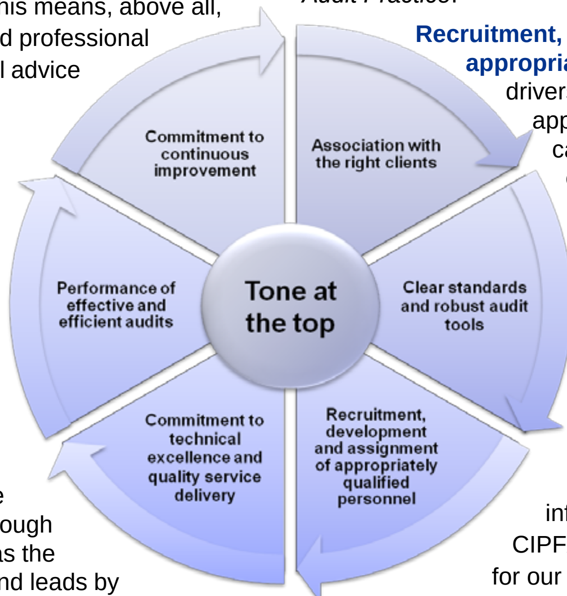
**KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG.**

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

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

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

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




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

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

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

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

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

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

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

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

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

# Appendix 6: KPMG Audit Quality Framework (continued)

**We continually focus on delivering a high quality audit.**

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

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

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

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

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

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

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

## Our quality review results

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

The latest Annual Regulatory Compliance and Quality Report (issued June 2014/2015) showed that we are meeting the overall audit quality and regulatory compliance requirements.

KPMG

*cutting through complexity™*