cutting through complexity™

Report to those charged with governance (ISA 260) 2012/13

Gloucester City Council

19 September 2013

Contents

The contacts at KPMG in connection with this report are:

Darren Gilbert
Director
KPMG LLP (UK)

Tel: 02920 468205
darren.gilbert@kpmg.co.uk

Tara Westcott
Manager
KPMG LLP (UK)

Tel: 0117 905 4358
tara.westcott@kpmg.co.uk

Duncan Laird
Assistant Manager
KPMG LLP (UK)

Tel: 0117 905 4253
duncan.laird@kpmg.co.uk

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 Darren Gilbert, 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, 3rd Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 03034448330.

Section one

Introduction

This report summarises:

- **the key issues identified during our audit of Gloucester City Council's (the Authority's) financial statements for the year ended 31 March 2013; and**
- **our assessment of the Authority's arrangements to secure value for money (VFM) in its use of resources.**

Financial statements

Our *External Audit Plan 2012/13* presented to you in March 2013. set out the four stages of our financial statements audit process.

Planning → Control Evaluation → Substantive Procedures → Completion

This report focuses on the second and third stages of the process: control evaluation and substantive procedures. Our on site work for these took place in two tranches during March 2013 (interim audit) and July / August 2013 (year end audit). We carried out the following work:

Control Evaluation

- Evaluate and test selected controls over key financial systems
- Review internal audit function
- Review accounts production process
- Review progress on critical accounting matters

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

Our *External Audit Plan 2012/13* explained our risk-based approach to VFM work, which follows guidance provided by the Audit Commission. We have completed our work to support our 2012/13 VFM conclusion. This included:

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

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 2012/13 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.

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

Background & context to this year's audit

The Authority has struggled for a number of years to prepare its financial statements on time to an appropriate quality, with particular difficulties in accounting for its fixed assets. This was exacerbated by significant changes to the Finance team during 2012. In order to improve the standard of accounting and financial management the Director of Resources took steps in 2012 to recruit a number of interim staff who have the technical skills which the Authority required. The 2011/12 audit was a long and difficult process which identified a large number of significant issues and audit adjustments, and the interim team itself found differences when revisiting the draft accounts. Consequently, our previous audit was not concluded and the accounts were not signed until six months after the statutory deadline. In addition, the Authority received a qualified Value for Money conclusion due to significant issues around budget monitoring and treasury management during the 2011/12 financial year.

Over the last year the Authority has taken steps to address these weaknesses, including implementing an improvement plan where progress is monitored regularly. These efforts have delivered improvements, for example:

- a complete set of accounts was available for audit by the statutory deadline of 30 June 2013;
- there has been a reduction in the number of audit issues identified during our accounts work (from the very high level seen last year); and
- there has also been an improvement in financial management arrangements through the reintroduction regular budget monitoring reporting to Members and senior management.

We commend the Authority for the improvements seen over the last year.

There remains the need for continued significant improvement, however. Our audit this year has still identified a sizeable number of significant adjustments and the Finance team itself identified further adjustments during the audit period as well. Further work is needed to maintain the positive direction of travel and we support the Director of Resources' intention to maintain the current arrangements involving regular comprehensive monitoring against the Finance Improvement Plan.

Two areas that are critically important to this improvement process are:

- completing the recruitment of a professionally qualified, adequately resourced and well supported Finance team (we note that this process has commenced recently with the new Head of Financial Services starting earlier this month); and
- the planned implementation of a new fixed asset accounting system during 2013/14 to replace the current spreadsheet based approach.

We will closely monitor both of these areas during our 2013/14 audit work. In the case of the new fixed asset system, we will need to undertake comprehensive additional audit work to gain comfort that the new system has been implemented appropriately and the data transferred into it is accurate and complete.

The next two pages in this section of the report set out the headline messages for specific elements of this year's audit. The remainder of the report then outlines our audit findings in more detail.

Headlines

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

Proposed audit opinion	Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion by 30 September 2013. We will also report that the wording of your Annual Governance Statement accords with our understanding.
Audit adjustments	Our audit has identified a total of four significant audit adjustments to date. The net impact of all the adjustments made between the draft and final versions of the financial statements (including adjustments identified by us and finance) is to: ■ decrease the balance on the general fund account as at 31 March 2013 by £41k; ■ increase the deficit on provision of services for the year by £668k; and ■ decrease the net worth of the Authority as at 31 March 2013 by £226k. We have included a full list of significant audit adjustments at **Appendix 3**. All of these were adjusted by the Authority with the exception of a reclassification between infrastructure and community assets and a review of intangible additions in the year. The Authority also identified a number of further adjustments required to the draft accounts during the audit. We have raised a number of recommendations in relation to the matters highlighted above, 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 taken steps to address the issues highlighted but further work is required to maintain the position going forward. Record keeping relating to fixed assets continues to be an area of concern. The Council uses an excel spreadsheet created from a download from the general ledger to account and record the movements on its fixed assets. This does not have the sophistication required to account for the Council's asset base or to cope with component accounting and other complexities associated with the requirements of local government capital accounting. The Authority has confirmed that a new asset register is expected to be implemented during the 2013/14 financial year. It is critical that data loaded onto the new system has been reviewed and cleansed to assure its accuracy and completeness.

Headlines (continued)

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

Accounts production and audit process	We have noted an improvement in the quality of the accounts and the supporting working papers from the previous year, but more work needs to be done to reduce the number of changes required to the draft accounts. The Authority has started the process of recruiting permanent post holders to key Finance positions and therefore it is critical that adequate knowledge transfer and handover processes from the interim team are in place. Officers dealt with audit queries within a reasonable timescale and the audit process has been completed within the planned timescales. Given the experience of recent years this is a notable achievement, which is testament to the considerable effort and focus of both the Finance and audit teams. The Authority has implemented 18 out of the 22 recommendations in our *ISA 260 Report 2011/12* relating to the financial statements. **Appendix 2** provides further information on those that remain outstanding.
Control environment	The Authority's organisation and IT control environment is effective overall. Based on the work carried out to provide assurance for the financial statement audit, controls over the key financial systems are generally sound. However, there are some weaknesses in respect of individual financial systems which have been reported by Internal Audit during the year. The Authority needs to ensure that Internal Audit's recommendations are implemented on a timely basis. We are satisfied that Internal audit complied with the Code of Practice for Internal Audit in Local Government and have again been able to place reliance on their work where this was relevant to our work.
Completion	At the date of this report our audit of the financial statements is substantially complete. The areas that remain outstanding are: ▪ confirmation from Hazlewoods (external auditors of Gloucester Airport Limited) that there are no issues of note which may affect the Group accounts; and ▪ review of the final Statement of Accounts to be presented to the Audit & Governance Committee to ensure all agreed audit changes have been reflected appropriately. Before we can issue our opinion we require a signed management representation letter. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.
VFM conclusion and risk areas	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 2013.

Proposed opinion and audit differences

Our audit has identified a total of four significant audit adjustments to date. The Authority has also identified further adjustments required to the draft accounts during the audit.

The net impact of these adjustments is to:

- **decrease the balance on the general fund account as at 31 March 2013 by £41k;**
- **increase the deficit on the provision of services for the year by £668k; and**
- **decrease the net worth of the Authority as at 31 March 2013 by £226k.**

Proposed audit opinion

Subject to the completion of all outstanding items outlined at page 5, we anticipate issuing an unqualified audit opinion by 30 September 2013.

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.

There have been a number of changes made to the draft accounts, both identified by the audit and by the Finance team as part of their ongoing review.

Our audit identified a total of four significant audit differences to date, which we set out in **Appendix 3**. These audit differences have been corrected in the financial statements.

There are two uncorrected audit difference relating to:

- reclassification of assets between infrastructure assets and community assets. This is a presentational difference only in the Plant, Property and Equipment Note; and
- potential reclassification of intangible asset additions.

The tables below illustrate the total impact of corrected audit differences and those identified by the Finance department and the impact on the General Fund for the year and balance sheet as at 31 March 2013. The net impact on the General Fund is a £41k decrease the balance as at 31 March 2013.

Movements on the General Fund 2012/13

£000's	Pre-audit	Post-audit
Deficit on the provision of services	(8,036)	(7,886)
Adjustments between accounting basis & funding basis under Regulations	7,474	7,283
Transfers from earmarked Reserves	257	257
Decrease in General Fund	**(305)**	**(346)**

Balance Sheet as at 31 March 2013

£000's	Pre-audit	Post-audit
Property, plant and equipment	176,360	175,960
Other long term assets	33,332	33,332
Current assets	20,724	19,644
Current liabilities	(27,846)	(29,092)
Long term liabilities	(118,173)	(115,673)
Net worth	**84,397**	**84,171**
General Fund	(2,157)	(2,116)
Other usable reserves	(9,855)	(9,671)
Unusable reserves	(72,385)	(72,384)
Total reserves	**(84,397)**	**(84,171)**

Proposed opinion and audit differences (continued)

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

Presentational adjustments

In addition, there were a number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting the United Kingdom 2012/13 ('the Code')*.

These were identified during the audit by both the audit team and by Finance as part of their ongoing review and include changes in the disclosure of senior officer remuneration and termination benefits, amending figures in the related party transactions note and correction of interest charges on PWLB loans.

The Authority has addressed and incorporated our amendments.

Annual Governance Statement

We have reviewed the amended 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.

Critical accounting matters

We have worked with Officers throughout the year to discuss specific risk areas. The Authority has taken steps to address the issues highlighted but further work is required to maintain the positive direction of travel.

Record keeping relating to fixed assets continues to be an area of concern.

In our *External Audit Plan 2012/13*, presented to you in March, we identified the key risks affecting the Authority's 2012/13 financial statements. We have also documented additional risks that have arisen during our audit work.

We have now completed our testing of these areas and set out our evaluation following our substantive work.

The table below sets out our detailed findings for each risk.

Key audit risk	Issue	Findings
Budgetary Control and Saving Plans	In the prior year the Council was not able to demonstrate that the reporting of financial information to senior management and Members took place. The Council was also unable to demonstrate (through documentation) that it was performing detailed budget monitoring and whether it was able to deliver on its savings plan. The Council forecast that it would deliver its 2012/13 budget, maintaining a general fund balance at £1.6m . This included delivering planned savings totalling £1.5m. In this context, it was important that budget monitoring was taking place, that savings could be identified and delivered, and that these arrangements are robust and evidenced.	We have reviewed the arrangements in place to produce and report budget monitoring information as part of our work on the VFM conclusion. The weaknesses identified in 2011/12 continued through the first half of 2012/13 but we recognised that Finance have introduced new procedures from September 2012 which have mitigated some of these risks. There still remains the need for continued improvement in this area and the need to provide regular comprehensive monitoring against the budget and savings plan to members. We concluded that the arrangements in place were adequate and that there was appropriate monitoring of performance against budget and savings plans. On page 19, within our VFM risks we set out more details.

Critical accounting matters (continued)

We have worked with Officers throughout the year to discuss specific risk areas. The Authority has taken steps to address the issues highlighted but further work is required to maintain the positive direction of travel.

Record keeping relating to fixed assets continues to be an area of concern.

Key audit risk	Issue	Findings
	We have reported to you in previous audits our concerns over certain reporting and record keeping of areas in the financial systems, in particular the controls around fixed asset recording and capital accounting. In the previous year we identified control weaknesses around fixed asset accounting which led to a number of material capital accounting errors within the financial statements.	Record keeping relating to fixed assets continues to be an area of concern. The Council uses an excel spreadsheet created from a download from the general ledger to account and record the movements on its fixed assets. This means that for many years the Council has been unable to identify what the historic cost of its assets are. Under the Code there is requirement for councils to keep this information and we have recommended that this is done in previous audits. In addition, by using simple downloads of the ledgers this does not have the sophistication required to account for the Council's asset base or to cope with component accounting and other complexities associated with the requirements of local government capital accounting. Significant work has been undertaken by the Finance team this year to improve the quality of the data held in the fixed asset spreadsheet. For example, ▪ a review has been carried out to ensure assets that are recorded within different categories only have one value assigned to them; and ▪ a review of the revaluation reserve has taken place to ensure that assets have been assigned the correct revaluation and that all balances are attributable to asset numbers. We have gained audit evidence from testing a sample of balances surrounding fixed assets and in particular reviewed additions, disposals. Finance have confirmed that a new asset register is expected to be implemented in October 2013. It is critical that the data loaded onto the new system has been reviewed thoroughly and cleansed to assure its accuracy and completeness.

Critical accounting matters (continued)

We have worked with Officers throughout the year to discuss specific risk areas. The Authority has taken steps to address the issues highlighted but further work is required to maintain the positive direction of travel.

Record keeping relating to fixed assets continues to be an area of concern.

Key audit risk	Issue	Findings
Fixed Asset Accounting (continued)	(continued)	During 2012/13 the Authority has made a judgement to book a £11.5m adjustment between the revaluation reserve and the Capital Adjustment Account (CAA) to address a number of historical issues with the balances within the revaluation reserve. The adjustment does not have any effect on the provision of services or the general fund and it is purely a re-allocation with the “unusable reserves” within the notes of the accounts. The adjustment relates to a tidy up of revaluation gains and losses which should have been taken the CAA in previous years, but which had not been done because of the issues surrounding the Authority’s capital accounting records that we have noted elsewhere in this report. We can confirm that we have reviewed this adjustment and even though the amount is large, we are satisfied that as this relates to movement between two related reserves that the adjustments made are not of a nature that requires specific disclosure as a prior year adjustment in the financial statements. We therefore agree with the accounting treatment the Authority has made.

Critical accounting matters (continued)

We have worked with Officers throughout the year to discuss specific risk areas. The Authority has taken steps to address the issues highlighted but further work is required to maintain the positive direction of travel.

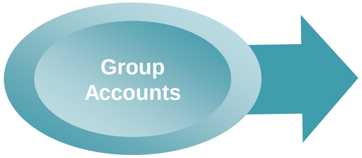
Record keeping relating to fixed assets continues to be an area of concern.

Key audit risk	Issue	Findings
Control Accounts	A number of issues were identified in the previous year in relation to control accounts which had not been appropriately maintained by the Authority. This resulted in large reconciliation exercises between the accounts and a number of material misstatements in the financial statements were identified due to unreconciled issues that had built up over time.	As part of our year end work, we reviewed the process for maintaining and clearing control accounts. We reviewed the Authority's trial balance to ensure that no suspense or holding accounts are being used. In particular we audited a number of the controls on the balance sheet in relation to NNDR and council tax to ensure that these had been reconciled correctly and agreed back to system generated reports and that they had been cleared down at the year end. We did not identify any significant issues with these balances.
Preparation of financial statements	Over the last few years the Authority has struggled to close down its accounts and prepare timely and accurate financial statements within the statutory timetable. This has resulted in multiple versions of the financial statements being presented to the audit team. In addition our audits have identified many material and significant errors and disclosure issues. There were also a number of Code changes and LAAP Bulletin updates during 2011/12 which were highlighted to Finance as part of our *Accounts Audit Protocol* but were not reflected in the draft accounts. The Authority's financial reporting team was weakened by staff changes in the prior year, and the Authority continues to rely on an Interim Finance team to resource and prepare the financial statements.	The process for the preparation of financial statements and the close down of the ledgers has improved from the prior year and we received a draft set of accounts on 24 June 2013, which was in advance the 30 June statutory deadline and our audit visit. The audit still identified a number of significant audit adjustments to the accounts but there were fewer than in previous years. The Authority also identified changes required during our audit as a result of their ongoing review of the accounts. We are pleased to note that an new Head of Financial Services is now in post and a number of other Finance positions are being fulfilled by experienced and technical component individuals. The Authority needs to ensure that it remains focused on the processes for closing down the ledgers and performing a thorough review of the accounts before they are submitted as draft for audit.

Critical accounting matters (continued)

We have worked with Officers throughout the year to discuss specific risk areas. The Authority has taken steps to address the issues highlighted but further work is required to maintain the positive direction of travel.

Record keeping relating to fixed assets continues to be an area of concern.

Key audit risk	Issue	Findings
	The Authority produces a consolidation spreadsheet which incorporated all of the Authority's subsidiaries, joint ventures and associates. We review the audited financial statements of the other bodies to be consolidated and agree the figures to the consolidation spreadsheet to ensure any material audit adjustments are reflected in the group accounts. In the prior year a number of group audit adjustments were identified.	In order to gain assurance over the Authority's group accounts, we place reliance over the work performed by the external auditors of Gloucester City Homes, Aspire Sports & Cultural Trust ("Aspire") and Gloucestershire Airport Limited. A prior year adjustment had been included in the draft accounts relating to Gloucester Airport. We reviewed the transaction and concluded that it was not material and did not warrant the treatment as a prior year adjustment in the Authority's group accounts. As a result an audit adjustment has been booked by Finance to treat this as a current year transaction. The audit of the group accounts identified that two associates which had been consolidated in previous years (Barton & Tredworth Developments and Marketing Gloucester) were not included in the accounts for 2012/13. This was because the Authority was not able to obtain the relevant information for 2012/13. We have reviewed the accounting entries for previous years and are satisfied that the amounts relating to these associates are immaterial to the overall group accounts. We have therefore concluded that, as allowed by the Code, it is appropriate for the associates not to be consolidated. During 2012/13, the Authority reviewed its relationship with Aspire and concluded that it no longer had control over this entity. A number of factors were taken into consideration by the Authority including the reduced level of funding Aspire receives from the Authority. We have performed a detailed review over this relationship and confirm that the accounting treatment is correct to deconsolidate this entity in 2012/13.

Accounts production and audit process

We have noted an improvement in the quality of the accounts and the supporting working papers from the previous year, but more work needs to be done to reduce the number of changes required to the draft accounts.

Officers dealt with audit queries within a reasonable timescale.

The Authority has implemented 18 out of the 22 recommendations in our *ISA 260 Report 2011/12* 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 strengthened its financial reporting process in 2012/13 and the overall quality of the accounts and supporting working papers demonstrated a considerable improvement from the prior year. There is scope for further improvement, particularly around capital accounting practices and workings. We consider that accounting practices are generally appropriate, however the Authority does not make an historic cost depreciation adjustment in the accounts. This is an issue we have raised in previous years.
Completeness of draft accounts	We received a complete set of draft accounts on 24 June 2013. The draft accounts were certified by the statutory deadline of 30 June. The Authority identified a number of amendments required in addition to the adjustments identified by the audit team during the final audit visit.
Response to audit queries	Officers resolved the majority of audit queries within a reasonable timescale.
Quality of supporting working papers	Our *Accounts Audit Protocol*, which we issued on 19 March 2013 and discussed with key members of Finance, set out our working paper requirements for the audit. The quality of working papers provided was variable but generally met the standards specified in our *Accounts Audit Protocol*. We noted an improvement in the quality of the supporting working papers overall.
Group audit	To gain assurance over the Authority's group accounts, we contacted the external auditors of Gloucester City Homes, Aspire Sports & Cultural Trust and Gloucestershire Airport Limited. This was to ensure that there were not any significant issues that should be brought to our attention, which may impact the Authority's group accounts. As we mention on page 5, we are still waiting confirmation from Hazlewoods auditors on the status of their audit.

Prior year recommendations

This year, Internal Audit have performed a piece of work to ensure that all external audit and internal audit prior year recommendations are being implemented by the Authority. We have relied on internal audits findings on this in order to avoid duplication of work.

Internal Audit has confirmed that in terms of the external audit recommendations, the Authority has implemented 18 out of the 22 in relation to the financial statements.

Appendix 2 provides further details.

Organisational and IT control environment

Your organisational and IT control environment is effective overall.

Work completed

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would have implications for our audit.

We obtain an understanding of the Authority's overall control environment and determine if appropriate controls have been implemented. We do not complete detailed testing of these controls.

The Authority relies on information technology (IT) to support both financial reporting and internal control processes. In order to satisfy ourselves that we can rely on the use of IT, we test controls over access to systems and data, system changes, system development and computer operations.

In completing this work, we partially relied on internal audit's reviews of sundry debtors, creditors and cash to bank. This has been complemented by our own testing of relevant IT controls in eFinancials.

Key findings

We consider that your organisational and IT controls are effective overall, but noted a small number of areas for further improvement:

- Issue 1: There is no formal review to confirm that the level of access that individuals have to IT systems such as Payroll, Cash Receipting, Council Tax, NNDR and Benefits is appropriate.
- Issue 2: Employees who have left the Authority are not being removed from the Authority's IT system on a timely basis.

These are continuing issues and were raised in last year's report and in our interim letter presented to the Audit Committee in June 2013.

We acknowledge however, that our sample selected for testing in both these areas was towards the beginning of the financial year. We confirm that internal audit's sample was on items selected towards the latter part of the year where no issues were identified.

The recommendations have therefore not been repeated here.

Aspect	Assessment
Organisational controls:	
Management's philosophy and operating style	3
Culture of honesty and ethical behaviour	3
Oversight by those charged with governance	3
Risk assessment process	3
Communications	3
Monitoring of controls	3
IT controls:	
Access to systems and data	2
System changes and maintenance	3
Development of new systems and applications	3
Computer operations and end-user computing	3

Key:
1 Significant gaps in the control environment.
2 Deficiencies in respect of individual controls.
3 Generally sound control environment.

Review of internal audit

We are satisfied that Internal audit complied with the *Code of Practice for Internal Audit in Local Government* and have again been able to place reliance on their work where this was relevant to our work.

We were able to place reliance on their work on the key financial systems.

Work completed

The scope of the work of your internal auditors and their findings inform our audit risk assessment.

We work with your internal auditors to assess the control framework for certain key financial systems and seek to rely on any relevant work they have completed to minimise unnecessary duplication of work. Our audit fee is set on the assumption that we can place full reliance on their work.

Where we intend to rely on internal audit's work in respect of the Authority's key financial systems, auditing standards require us to complete an overall assessment of the internal audit function and to evaluate and test aspects of their work.

For 2012/13, the *Code of Practice for Internal Audit in Local Government* defined the way in which the internal audit service should undertake its functions.

We reviewed internal audit's work on the key financial systems and re-performed a sample of tests completed by them.

Key findings

Based on the self-assessment performed by internal audit, our assessment of their files, attendance at Audit Committee and regular meetings during the course of the year, internal audit complied with the *Code of Practice for Internal Audit in Local Government*.

We did not identify any significant issues with internal audit's work and are pleased to report that we are again able to place reliance on internal audit's work on the key financial systems.

Public Sector Internal Audit Standards

Since April 2013, the United Kingdom Public Sector Internal Audit Standards (PSIAS) apply across the whole of the public sector, including local government. These standards are intended to promote further improvement in the professionalism, quality, consistency and effectiveness of internal audit across the public sector. The PSIAS replace the *Code of Practice for Internal Audit in Local Government*. Additional guidance for local authorities is included in the *Local Government Application Note* on the PSIAS.

The Head of Internal Audit reported to the Audit & Governance Committee on the introduction of PSIAS as part of the internal audit self-assessment of effectiveness. The Internal Audit Charter and the Internal Audit Strategy will be reviewed in the context of the PSIAS requirements and updated as necessary.

Controls over key financial systems

The controls over the majority of the financial systems are generally sound.

However, there are some weaknesses in respect of individual financial systems which have been reported by Internal Audit.

Work completed

We review the outcome of internal audit's work on the financial systems to influence our assessment of the overall control environment, which is a key factor when determining the external audit strategy.

We also work with your internal auditors to update our understanding of some of the Authority's key financial processes where these are relevant to our final accounts audit.

Where we have determined that this is the most efficient audit approach to take, we test selected controls that address key risks within these systems. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

Our assessment of a system will not always be in line with the internal auditors' opinion on that system. This is because we are solely interested in whether our audit risks are mitigated through effective controls, i.e. whether the system is likely to produce materially reliable figures for inclusion in the financial statements.

Financial system	Internal audit rating
Council Tax	Good
NNDR	Good
Payroll	Satisfactory/ Unsatisfactory
Cash & bank	Good/Limited
Creditors	Good
Sundry debtors	Good/ Satisfactory/ Limited
Treasury management	Good/Limited
Housing and Council Tax benefits	Satisfactory
Capital accounting	Limited

Internal Audit use split assessments when grading their reports to highlight particular weaknesses on specific controls which merit attention.

Key findings

Based on the work of your internal auditors and our own testing, the controls over the majority of the financial systems are sound. As highlighted above, there remains a particular need to strengthen the Authority's capital accounting controls.

Where weaknesses were identified in individual financial systems, Internal Audit included recommendations in their reports as appropriate.

With the exception of capital accounting, these weaknesses did not significantly impact on our audit strategy. However, we endorse the recommendations made by Internal Audit during the year and support the need for the Authority to address these issues.

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 Gloucester City Council for the year ending 31 March 2013, we confirm that there were no relationships between KPMG LLP and Gloucester 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 Director of Resources, 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, 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 or our previous reports relating to the audit of the Authority's 2012/13 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. In particular, we have considered the specific issues that led to the qualification of the VFM conclusion in 2011/12 and are satisfied that the Authority has sufficiently addressed the weaknesses identified.

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

The following pages include further details of our VFM risk assessment and our specific risk-based work.

Specific VFM risks

We have identified a number of specific VFM risks.

We are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

Work completed

In line with the risk-based approach set out on the previous page, and in our Audit Plan 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, other inspectorates and other 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 for some of these risks. This work is now complete and we also report on this below.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
	We highlighted in our ISA 260 Report 2011/12 that we had concerns over budgetary control. We need to consider in more detail the controls in place to monitor the budget. This is relevant to both the financial resilience and economy, efficiency and effectiveness criteria of the VFM conclusion.	Due to the need to work on last year's accounts, the interim Finance team were unable to focus their efforts on producing management accounts for the first five months of the 2012/13 financial year. However, since September 2012 the Finance team have been preparing timely monthly management accounts which agree back to actual figures per their systems. These management accounts contain core financial information (e.g. I&E, balance sheet, movement in reserves and some narrative explanations). However we note in **Appendix 2** further improvement that can be made. We have also attended a Gloucester Leadership Team (GLT) meeting in June 2013 to understand the process and the information provided to members. We confirm that the monthly management accounts and saving plans are discussed and are standing item at these meetings. We acknowledge the improvements that have been made by the Authority and stress the importance of this process. We recommend that meetings are minuted where detailed financial information and savings plans are discussed to ensure that there is sufficient audit evidence to demonstrate the discussions as part of the monitoring process.

Specific VFM risks (continued)

We have identified a number of specific VFM risks.

We are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Savings Plans	In 2011/12, no outturn position was reported and we were unable to substantiate the year end position in regard to the savings target. There is a risk that savings plans are not being monitored and that the Authority does not make the required savings in order to meet its budget. This is relevant to the financial resilience criteria of the VFM conclusion.	The savings plan target for the Authority for 2012/13 was £1.5m. This was built into the budget agreed by the Council and Cabinet at the start of the year. Although Finance do not produce a final outturn position at year end, the March 2013 management accounts report that actual spend was close to budget.
Treasury Management	In 2011/12 we identified that treasury management actions had been taken that did not support the Authority's overall strategy or policy. There is a risk that treasury management decisions are not in line with the Authority's policy and do not provide value for money. This is relevant to the financial resilience criteria of the VFM conclusion.	No further loans were taken out in 2012/13 therefore there was limited treasury management activity in the year. The Internal Audit review of Treasury Management concluded that there was a good level of assurance on the adequacy and operating effectiveness of controls over the daily operation of treasury management functions. No issues relating to treasury management have been identified in 2012/13.

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	❶	**Review of community and intangible assets** Further work is required by the Authority to consider whether community and intangible assets are categorised correctly within fixed assets in the accounts. From our review of the Authority's fixed asset register a number of assets £7.1m were identified as infrastructure assets but with descriptions that may indicate that they are community assets. From our initial review of intangible asset additions in the year, which amount to £847k, it is not clear from the descriptions whether all the expenditure is capital in nature and meets the definition of an intangible asset under the Code. **Recommendation** Undertake a detailed review of the above classes of assets to identify whether they meet the definition of capital expenditure as per the Authority's accounting policy and per the Code (for intangibles) and have been correctly classified (for infrastructure / community assets).	The infrastructure assets with a value of £7.1m have been historically been classified as such for several years. Any reclassification of these assets will be of a presentational nature only and will have no impact on the Income and Expenditure account as the depreciation rates will remain unchanged. We are essentially satisfied with the treatment and classification of the intangible assets additions in the current year as the vast majority of this relates to capitalised labour costs, however, we acknowledge the need to carry out a detailed review of these assets and reclassify or expense where considered necessary. The Council is already carrying out a detailed review of the classification of infrastructure and intangible assets in the current financial year. This will be carried out prior to the uploading of the assets register onto the new system which is scheduled to take place prior to 31 March 2014. Albeit, recognised as an issue we consider the point to not be a class 1 risk, as there is no impact on the level of General Reserve or a mis-statement of the Balance Sheet.

Appendix 1: Key issues and recommendations (continued)

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.

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
2	2	**Historic cost depreciation adjustment** As in previous years, the Authority has not made a historic cost depreciation adjustment in 2012/13. The Authority has identified that there are excess balances on the revaluation reserve where the net book value of the asset is nil. These are now being written off to the Capital Adjustment Account but are the result of not making historic cost depreciation adjustments in previous years. **Recommendation** Make an adjustment each year between the Revaluation Reserve and the Capital Adjustment Account to ensure that, where assets are fully written down, there is no residual balance in the Revaluation Reserve.	The way the asset register is currently set up makes it extremely time consuming and impractical to carry out a detailed calculation to make an adjustment in respect of historic cost. We have made significant progress over the last financial year and the current financial year in tidying up and analysing the revaluation reserves and arriving at a detailed and fairly accurate analysis of the revaluation reserve by individual asset, however, the current asset register does not provide sufficient detail to calculate an accurate historical cost adjustment. The Council will, however, in future adjust the revaluation reserve as follows: • When assets are sold any remaining revaluation reserve balance will be eliminated. • As we have done in the 2013 financial year the revaluation reserve balance for individual assets will be compared to the net book value of the asset and, where the reserve exceeds the asset value an adjustment will be made to the revaluation reserve to equal the asset value.
3	2	**Recording of Council Dwelling valuations** Following the revaluation exercise for council dwellings, the downward movements on assets have been posted as an overall revaluation reserve adjustment and impairment without reference to movements on individual archetypes. For 2012/13 this is not an issue as the downward revaluation is so large that it wipes out the full revaluation reserve balance, but in future years the valuation movement should be recorded by archetype. **Recommendation** Ensure that the new Fixed Asset Register records the valuation of each archetype to ensure that asset movements can be correctly calculated.	We are grateful to the auditors for demonstrating further issue of good practice for the Council to adopt, although this point has not been raised with the Council until publication of the ISA 260 report. We will aim to analyse dwellings by archetype when setting up the new fixed assets register and all future revaluation adjustments relating to dwellings will, as far as is possible and practical, be analysed by archetype rather than in total as at present.

Appendix 1: Key issues and recommendations (continued)

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.

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
4	3	**Review of historical ledger codes** Individual balances in the financial statements, such as debtors and reserves, are made up of a large number of nominal ledger codes. Some General Ledger codes contain cumulative historical data (e.g. one code for rent due and another code for rent received). An exercise has not been performed to clear these codes down at the year end and to remove the number of nominal ledger codes used for one balance. This could lead to a risk that not all nominal ledger codes are included and the risk of mis-posting transactions. **Recommendation** Review and rationalise the number of nominal ledger codes within the general ledger to ensure that this is more manageable for Finance.	We are fully aware that there are numerous general ledger for items such as reserves and debtors several of which are unnecessary or superfluous as well as those that have cumulative historical data. A full review of the general ledger codes is underway and will be completed in the 2013-14 financial year. Where necessary codes are being consolidated, particularly those relating to reserves, and other balance sheet codes. It is the intention for 2013-14 to create fixed assets additions and disposal codes that represent the additions/disposals within the current year. Therefore, the brought forward balances will represent the closing balances of the previous year.

Appendix 2: Follow up of prior year recommendations

The Authority has not implemented all of the recommendations in our *ISA 260 Report 2011/12.*

We re-iterate the importance of the outstanding recommendations and recommend that these are implemented as a matter of urgency.

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2011/12* and re-iterates any recommendations still outstanding.

This year, we have relied on the work performed by Internal Audit on reviewing and testing prior year recommendations to ensure they have been implemented during the year. Internal Audit have confirmed that there remain four recommendations outstanding.

Number of recommendations that were:	
Included in original report	22
Implemented in year or superseded	18
Remain outstanding (re-iterated below)	4

No.	Risk	Issue and recommendation	Status as at September 2013
1	❶	**Budgetary control** At our interim visit we highlighted to you as part of our Interim Report 2011/12 that we had concerns over budget monitoring and reporting. We confirmed that detailed reports had not been produced since September 2011 and that we have not been able to reconcile the figures produced back to the finance system. Our audit procedures also identified an error where a missing invoice was found in 2011/12 that related to 2010/11, relating to a significant contract. If there had been effective budgetary control during the year then such an error would have been identified through the budget monitoring process. ***Recommendation*** Budget monitoring should be completed on a monthly basis. The summary reports presented to Cabinet should reconcile to the detailed monitoring reports produced by Finance.	Budget monitoring is a standing item on the GLT meeting agenda. Management accounts have been produced on a monthly basis since September 2012 and reconcile to the underlying figures in the finance system. Internal Audit's follow up of progress during 2012/13 and up to July 2013 identified that whilst the cycle of monthly budgetary meetings with cost centre managers has commenced, it still requires complete rollout. **Management Response** This is a work-in-progress and will be completely rolled out by 31 December 2013.

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

The Authority has not implemented all of the recommendations in our *ISA 260 Report 2011/12.*

We re-iterate the importance of the outstanding recommendations and recommend that these are implemented as a matter of urgency.

No.	Risk	Issue and recommendation	Status as at September 2013
2	❶	**Bank Reconciliations** Our work and that of Internal Audit identified that bank reconciliations were not being performed correctly. There were a number of balancing figures within the monthly reconciliation. Although these amounts were not significant they were in effect 'balancing figures' meaning that the bank accounts did not reconcile to the general ledger. Our work on cash at year end also identified that a bank account had been missed out of the reconciliation process which resulted in cash in the financial statements being understated. ***Recommendations*** Identify what is causing the unreconciled amounts. Future bank reconciliations should be performed on a zero variance basis. All bank accounts should be reviewed by a senior member of the Finance team to ensure that they are all reconciled at month end correctly and all accounts are being captured.	Our review of the year end bank reconciliation identified that a £9k manual journal was required to balance the reconciliation. This journal was noted in 2011/12 and had not been cleared. The finance team have confirmed that this difference has been cleared post year end. Internal Audit's follow up of progress during 2012/13 and up to July 2013 identified that there were a series of unreconciled credits and debits dating back to March 2008 on the bank reconciliations. **Management Response** The £9k adjustment has subsequently cleared. The unreconciled debits and credits per the July 2013 reconciliation include 6 items with a net value of less than £1k relating to prior to 2013 of which only one relates to March 2008 which has a value of £9. We are in the process of reviewing all long outstanding items with the aim of clearing or writing off such items by 30 September 2013.

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

The Authority has not implemented all of the recommendations in our *ISA 260 Report 2011/12.*

We re-iterate the importance of the outstanding recommendations and recommend that these are implemented as a matter of urgency.

No.	Risk	Issue and recommendation	Status as at September 2013
3	❶	**Resources within Finance** The Council's accounts and accounting requirements are complex. It is paramount within a finance department that you have suitable qualified staff who have the technical ability in local government accounting to deal and account for these transactions. ***Recommendation*** We recommend that a permanent finance structure is put in place urgently.	Changes have been implemented to the Finance team structure in order to focus upon the separate elements of the service delivery, with further work being undertaken to define the roles of individual officers. Key appointments within the Finance department are being concluded by the end of December. **Management Response** The Council has recently appointed a new Head of Financial Services who joined the Council at the beginning of September 2013. A new management accountant has been appointed and scheduled to commence work on 1 November 2013. The position of the financial accountant will be advertised before the end of September 2013 and it is anticipated that an appointment will be made and in post before the end of December 2013. Impact of these changes will be mitigated by an extended handover from the Interim to the Permanent team. With these appointments having been made allied to the finalisation of the finance department restructuring process the department will be well placed to make further improvements to those already made in the finance function.

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

The Authority has not implemented all of the recommendations in our *ISA 260 Report 2011/12.*

We re-iterate the importance of the outstanding recommendations and recommend that these are implemented as a matter of urgency.

No.	Risk	Issue and recommendation	Status as at September 2013
4	2	**Journals** Only one member of staff within Finance has the required knowledge of how to produce journal reports. During our audit this member of staff was on sick leave and the journal list could not be produced. Upon our request of this report, the interim Finance team had to go back to their Cedar supplier to obtain the report. We also identified that a material error was made by a member of Finance where a journal was posted the wrong way round. This journal had not been reviewed prior to being posted. ***Recommendation*** Process notes for key finance processes should be maintained to ensure that knowledge is not lost when there is a turnover or unavailability of key staff. Material journals should be reviewed and approved by a senior member of the Finance team either prior to being posted or retrospectively.	Internal Audit's follow up of progress for 2012/13 identified that the process for raising journal reports has been transferred from an Accountancy Assistant to an Accountancy Technician, providing additional team knowledge to produce the reports. The Finance Change Manager confirmed that a senior consultant raises all journal requests for revenue, capital and the HRA and that these requests are reviewed by Finance prior to processing. Management accounts are reviewed by the Finance Change Manager and a senior member of the Finance team on a monthly basis and any issues would be identified at this point. However, process and guidance notes on how to run the reports are still being drafted and finalised. **Management Response** The documentation relating to journals is in place, we are currently reviewing and documenting all procedures and tasks within Financial Services. This is an action emanating from the Finance department restructure. These will be completed before the end of the 2013-14 financial year.

Appendix 3: Audit differences

This appendix sets out the significant audit differences.

The corrected audit differences have been adjusted by the Authority.

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 Audit & Governance 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 differences identified by our audit of Gloucester City Council's financial statements for the year ended 31 March 2013. These have been corrected by the Authority.

Impact						Basis of audit difference
No.	Income and Expenditure Statement	Movement in Reserves Statement	Assets	Liabilities	Reserves	
1	Cr Revaluation losses £1,173k	Dr Adjustments between accounting basis & funding basis under regulations £1,173k			Dr Revaluation reserve £2,239k Cr CAA £2,239k	A number of asset with a balance in the revaluation reserve which had impairments taken to I&E in previous years. This adjustment is to correct the accounting treatment i.e. to remove the balance from the revaluation reserve (so that the balance is nil) and any remaining balance to be taken to the I&E.
2			Cr Short term debtors £1,386k	Dr Short term creditors £1,386k		Adjustment to NNDR debtors/creditors. Previously presented within both short term creditors (with central government bodies) and short term debtors (with central government bodies). This has been amended to show one net debtor or creditor, as required by the Code.
3				Dr Long term borrowings £2,500k Cr Short term borrowings £2,500k		Adjustment relating to the reclassification of PWLB long term borrowings to show this element as short term as it is repayable within 12 months of the year end.

Appendix 3: Audit differences (continued)

This appendix sets out the significant audit differences.

The corrected audit differences have been adjusted by the Authority.

Corrected audit differences (continued)

No.	Impact: Income and Expenditure Statement	Impact: Movement in Reserves Statement	Impact: Assets	Impact: Liabilities	Impact: Reserves	Basis of audit difference
4				Cr Long term liabilities £209k	Dr Group useable reserves £209k	The draft financial statements reflected a prior year adjustment relating to Gloucester Airport. As the amounts involved are not material to the Group accounts this does not warrant a prior year adjustment. This has therefore been corrected so that it is made as an adjustment in the current financial year.
	Cr £1,173k	**Dr £1,173k**	**Cr £1,386k**	**Dr £1,177k**	**Dr £209k**	**Total impact of adjustments**

Appendix 3: Audit differences (continued)

This appendix sets out the significant audit differences.

The corrected audit differences have been adjusted by the Authority.

Uncorrected audit differences

The following table sets out the uncorrected audit differences identified by our audit of Gloucester City Council's financial statements for the year ended 31 March 2013.

	Impact					
No.	**Income and Expenditure Statement**	**Movement in Reserves Statement**	**Assets**	**Liabilities**	**Reserves**	**Basis of audit difference**
1			Dr Community Assets £7,100k Cr Infrastructure Assets £7,100k			Review of the Council's fixed asset records identified a large number of assets listed as infrastructure assets, but with descriptions that indicate they may actually be community assets. Examples include parks, playing fields, skate parks and recreation areas. Further work is required by the Council to consider whether the current categorisation is appropriate, or whether there are any assets that should be reclassified. The total potential error, based on the items identified through our review, is £7.1m, although we acknowledge that a thorough review of the assets concerned may confirm that the current classification treatment for some of these assets may be correct. This issue relates to the classification of fixed assets, and so is a disclosure issue only. It does not affect the valuation in the balance sheet.

Appendix 3: Audit differences (continued)

This appendix sets out the significant audit differences.

The corrected audit differences have been adjusted by the Authority.

Uncorrected audit differences (continued)

	Impact					
No.	**Income and Expenditure Statement**	**Movement in Reserves Statement**	**Assets**	**Liabilities**	**Reserves**	**Basis of audit difference**
2	Dr Expenditure £847k		Dr PPE £847k	Cr Intangible Assets £847k		From a high level review of the Authority's intangible assets we have identified that additions for 2012/13 may include some assets which are not deemed intangibles per the Authority's accounting policy and per the Code. Further work is required by the Authority to consider whether the current categorisation is appropriate, or whether there are any assets that should reclassified. The total potential error based on the additions for this year is £847k although we acknowledge that a thorough review of the assets concerned may confirm that the current treatment may be correct.
	Dr £847k	**-**	**Dr £847k**	**Cr 847k**	-	**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 Audit & Governance 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. 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 Gloucester City Council for the financial year ending 31 March 2013, we confirm that there were no relationships between KPMG LLP and Gloucester 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 financial statements of Gloucester City Council ("the Authority"), for the year ended 31 March 2013, for the purpose of expressing an opinion:

i. as to whether these financial statements give a true and fair view of the financial position of the Authority and its Group as at 31 March 2013 and of its expenditure and income for the year then ended; and

ii. whether the financial statements have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

These financial statements comprise the Authority and Group Movement in Reserves Statements, the Authority and Group Comprehensive Income and Expenditure Statements, the Authority and Group Balance Sheets, the Authority and Group Cash Flow Statements, 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 the Authority and the Group as at 31 March 2013 and of the Authority's and the Group's expenditure and income for the year then ended; and
   - have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.
2. The financial statements have been prepared on a going concern basis.
3. Measurement methods and significant assumptions used by the Authority in making accounting estimates, including those measured at fair value, are reasonable.
4. 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 2012/13 require adjustment or disclosure have been adjusted or disclosed.
5. The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to this representation letter.

Information provided

6. 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.

Appendix 5: Draft management representation letter

7. All transactions have been recorded in the accounting records and are reflected in the financial statements.

8. 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.

   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 the 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 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.

11. 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 2012/13 all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.

12. The Authority has disclosed to you the identity of the Authority's and the Group's related parties and all the related party relationships and transactions of which it is aware and all related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

    Included in the Appendix to this letter are the definitions of both a related party and a related party transaction as the Authority understands them and as defined in IAS 24, except where interpretations or adaptations to fit the public sector are detailed in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

13. 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.

    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

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

This letter was tabled and agreed at the meeting of the Audit & Governance Committee on 23 September 2013.

Yours faithfully,

Chair of Audit & Governance Committee, Director of Resources cutting through complexity™