KPMG

External audit report 2016/17

Gloucester City Council

—

5 September 2017

Summary for Audit Committee

Financial statements

This document summarises the key findings in relation to our 2016-17 external audit at Gloucester City Council ('the Authority').

This report focusses on our on-site work which was completed in July 2017 on the Authority's significant risk areas, as well as other areas of your financial statements. Our findings are summarised on pages 4 – 5.

Our report also includes additional findings in respect of our control work which we have identified.

Subject to all outstanding queries being resolved to our satisfaction we anticipate issuing an unqualified audit opinion on the Authority's financial statements before the deadline of 30 September.

We have identified two audit adjustments with a total value of £1,091 million of which one adjustment of £0,833 million remains unadjusted in the accounts. Whilst this difference is significant in value, it does not exceed our materiality level and therefore we are content with management's decision not to adjust itin the financial statements on the basis of its immateriality, and instead to address through next year's accounts. This will be confirmed through the representation letter we have requested. See page 25 for details.

Based on our work, we have raised 1 recommendation. Details on our recommendations can be found in Appendix 1.

We are now in the completion stage of the audit.

Use of resources

We have completed our risk-based work to consider whether in all significant respects the Authority has proper arrangements to ensure has taken properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. 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 value for money opinion.

See further details on page 15-21.

Acknowledgements

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

We ask the Audit Committee to note this report.

KPMG

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Section one

Financial Statements

We anticipate issuing an unqualified audit opinion on the Authority's 2016/17 financial statements by 30 September 2017. We will also report that your Annual Governance Statement complies with the guidance issued by CIPFA/SOLACE (*'Delivering Good Governance in Local Government'*) published in April 2016.

For the year ending 31 March 2017, the Authority has reported a deficit on the provision of services of £4.5m. This has resulted in an increase in the General Fund of £0.7m following various adjustments between the Council's accounting basis and funding basis, such as the reversal of depreciation and other capital transactions, adjustments to pensions costs and recognition of a statutory borrowing provision.

Significant audit risks

Our *External Audit Plan 2016/17* sets out our assessment of the Authority's significant audit risks. We have completed our testing in these areas and set out our evaluation following our work:

Significant audit risks	Work performed
1. Significant changes in the pension liability due to LGPS Triennial Valuation	**Why is this a risk?** During the year, the Pension Fund has undergone a triennial valuation with an effective date of 31 March 2016 in line with the *Local Government Pension Scheme (Administration) Regulations 2013*. The share of pensions assets and liabilities for each admitted body is determined in detail, and a large volume of data is provided to the actuary to support this triennial valuation. There is a risk that the data provided to the actuary for the valuation exercise is inaccurate and that these inaccuracies affect the actuarial figures in the accounts. Most of the data is provided to the actuary by Gloucestershire County Council, who administer the Pension Fund. **Our work to address this risk** We have reviewed the process used to submit relevant payroll data to the Pension Fund and have found no issues to note. We have obtained assurance from the scheme auditor in relation to data provided by the administering council. We have also substantively agreed the total figures submitted to the actuary to the ledger with no issues to note. Alongside this, our KPMG actuarial specialists have reviewed the assumptions of the GCC scheme actuary and found them to be reasonable.
2. New core financial system implementation	**Why is this a risk?** The Council implemented a new accounting system, Civica financials, during the financial year. This implementation replaces the Council's current general ledger, fixed asset register, accounts receivable and accounts payable modules. The new system is managed by Malvern Hills District Council (MHDC) within a shared services arrangement. MHDC already has an existing arrangement to manage the Civica system on behalf of another district, so Gloucester is joining an existing arrangement. The whole year's transactions were transferred from the existing e-Financials system to the new financial system. There is a risk that the data does not transfer correctly or completely, or that the Council's feeder systems (e.g. Revenues and Benefits) do not correctly interface with the new system. **Our work to address this risk** Additional work was performed over the system migration process as well as over key reconciliations, especially between the general ledger and the Council's existing systems such as Civica Revenues & Benefits. As internal audit did a specific review in this area, we initially reviewed the extent and results of the internal audit work and used our IT specialists within our audit team to perform necessary top-up work following the review of IA work. We have also held enquiries with the Council, the Malvern Hills team and IA regarding the project. No issues were noted in our testing.

Considerations required by professional standards

Fraud risk of revenue recognition

Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.

In our *External Audit Plan 2016/17* 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.

This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.

Management override of controls

Professional standards require us to communicate the fraud risk from management override of controls as significant because 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.

Our audit methodology incorporates the risk of management override as a default significant risk. We have not identified any specific additional risks of management override relating to this audit.

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.

There are no matters arising from this work that we need to bring to your attention.

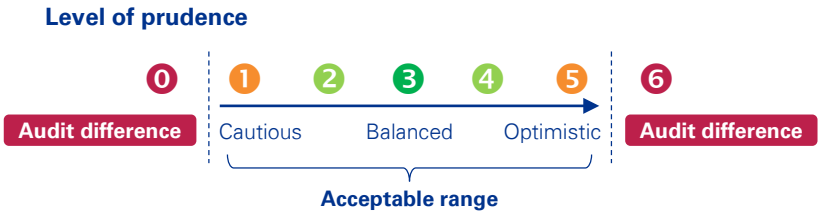
Other areas of audit focus

We identified three areas of audit focus. These are not considered as significant risks as they are less likely to give rise to a material error. Nonetheless these are areas of importance where we would carry out substantive audit procedures to ensure that there is no risk of material misstatement.

Other areas of audit focus	Our work to address the areas
1. Disclosures associated with retrospective restatement of CIES, EFA and MiRS	**Background** CIPFA has introduced changes to the 2016/17 Local Government Accounting Code (Code): — Allowing local authorities to report on the same basis as they are organised by removing the requirement for the Service Reporting Code of Practice (SeRCOP) to be applied to the Comprehensive Income and Expenditure Statement (CIES); and — Introducing an Expenditure and Funding Analysis (EFA) which provides a direct reconciliation between the way local authorities are funded and prepare their budget and the CIES. This analysis is supported by a streamlined Movement in Reserves Statement (MiRS) and replaces the previous segmental reporting note. The Authority was required to make a retrospective restatement of its CIES (cost of services) and the MiRS. New disclosure requirements and restatement of accounts require compliance with relevant guidance and correct application of applicable accounting standards. **What we have done** For the restatement, we obtained an understanding of the methodology used to prepare the revised statements. We have also agreed figures disclosed to the Authority's general ledger and found no issues to note. We made some suggestions to improve the note to facilitate easier reconciliation to the Council's final outturn statement; these suggestions have been built into the final accounts by the Council.
2. Valuation of property	**Background** The Council holds a significant property portfolio and needs to consider whether the carrying value of property assets are materially stated as at the balance sheet date. **What we have done** We have reviewed the appropriateness of the valuation methodology and considered the expertise of the valuers performing the exercise, and in addition reviewed the Council's consideration of the accuracy of the year-end carrying value of properties not revalued at the balance sheet date. We have tested a sample of revaluations to confirm accurate treatment and accounting. No issues were identified in our testing.
3. Restructuring programme	**Background** The Council has undergone a restructuring programme, Together Gloucester, during the year. This will be considered in relation to VFM on page 20, but there is also an impact on the financial statements in terms of potential provisions required for restructuring (e.g. redundancy costs) and disclosures of redundancy payments. **What we have done** An understanding was obtained around the progress of the programme and the potential costs required, this included a review of any provisions/accruals and disclosures within the accounts in relation to the project. We have raised an audit adjustment in order to recognise a provision in relation to the redundancy costs resulting from the project (see page 26).

Judgements

We have considered the level of prudence within key judgements in your 2016/17 financial statements and accounting estimates. We have set out our view below across the following range of judgements.



Subjective areas	2016/17	2015/16	Commentary
Provisions (excluding NDR appeals)	4	3	The judgement over the provision for bad debts is calculated on long outstanding council tax, Sundry debtors, NNDR balances and a percentage of aging on Housing Benefits. The methodology stayed consistent with the prior year approach taken. The Council also holds some immaterial provisions in relation to injury and damage compensation claims. We consider the provision level to be appropriate with the exception of the immaterial audit adjustment we have raised in relation recognising a provision for the restructuring scheme (see page 26).
NDR appeal provisions	3	3	This provision covers the estimated cost to the Council resulting from appeals by ratepayers against their rateable value; the provision has increased by £0.3m this year. We consider the provision level to be appropriate.
Pensions	3	3	Assumptions are set in calculating the liability amount discounted at a rate of 2.5% (PY 3.4%), for the current year the life expectancy decreased for both current pensioners and future pensioners and the inflation rate was set at 2.4% (PY 2.1%). Key assumptions are in the middle of KPMG's acceptable range.
Property, Plant and Equipment (valuations / asset lives)	4	4	Property, plant and equipment is made up of 67% Land and Buildings, 14% Infrastructure assets,11% Community assets and 8% Vehicles, plant, furniture and equipment. The property assets are depreciated over their useful lives and valued over a five year period. An in-house valuer assesses 20% of these assets each year across each asset class. We reviewed a sample of revalued assets and noted that these were accounted for correctly. We consider that the valuation approach for this year is sufficient to avoid the risk of a material audit difference in the assets which have not been revalued, but the Council should remain alert to the potential of material movements in non-revalued asset values in future years.

Proposed opinion and audit differences

We anticipate issuing an unqualified audit opinion on the Authority's 2016/17 financial statements following approval of the Statement of Accounts by the Audit Committee on 18 September 2017.

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 3 for more information on materiality) level for this year's audit was set at £1.6m million for the Authority's accounts and £1.75m for the Group accounts. Audit differences below £0.080 million are not considered significant.

Our audit identified a total of two significant audit differences, which we set out in Appendix 2. Management did not wish to correct the misstatement identified around the restructuring provision as it will not have a material effect on the financial statements.

The tables on the right illustrate the total impact of audit differences (adjusted and unadjusted audit differences) on the Authority's movements on the General Fund for the year and balance sheet as at 31 March 2017.

As the one corrected misstatement only impacts on the way tax flow through the group accounts with no impact on general fund, it is not included in the tables, and as such, the tables illustrate the balances which would be recognised if management corrected the unadjusted difference relating to the restructuring provision as set out on page 26.

In addition, 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 2016/17 ('the Code'). We understand that the Authority will be addressing these where significant.

Movements on the general fund 2016/17

£m	Pre-audit	Post-audit[1]	*Ref*
Deficit on the provision of services	(4,542)	(5,375)	Page 26
Adjustments between accounting basis and funding basis under Regulations	5,253	6,086	-
Transfers to/from earmarked reserves	692	692	-
Movement in General Fund	**1,403**	**1,403**	Page 26

Balance sheet as at 31 March 2017

£m	Pre-audit	Post-audit[1]	*Ref*
Property, plant and equipment	63,639	63,639	-
Other long term assets	31,020	31,020	-
Current assets	10,616	10,616	-
Current liabilities	(19,570)	(20,403)	Page 26
Long term liabilities	(76,738)	(76,738)	-
Net worth	**8,967**	**8,134**	Page 26
General Fund	5,922	5,922	Page 26
Other usable reserves	5,594	4,761	-
Unusable reserves	(2,549)	(2,549)	-
Total reserves	**8,967**	**8,134**	Page 26

[1] This represents the impact of correcting the one unadjusted difference of £833k. The final post-audit accounts presented to members have no adjustments to general fund and balance sheet compared to the draft approved prior to our audit.

Annual governance statement

We have reviewed the Authority's 2016/17 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.

We have made a number of comments in respect of its format and content which the Authority has agreed to amend where significant.

Narrative report

We have reviewed the Authority's 2016/17 narrative report and have confirmed that it is consistent with the financial statements and our understanding of the Authority.

We have noted that while there is a list of non-financial achievements detailed in the Report, there are no non-financial Key Performance Indicators, as the Council is still in the process of revising its KPI system. The Accounts and Audit Regulations 2015 include this specific requirement and, whilst they are not explicit in what this requires, we believe the Council should consider for future years how it can expand on the information included in the Narrative report to fulfil the requirements from the Regulations.

Our VFM section includes more detail on this area.

Accounts production and audit process

Our audit standards (*ISA 260*) require us to communicate our views on 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. The efficient production of the financial statements and good-quality working papers are critical to meeting the tighter deadlines.

Accounting practices and financial reporting

The Authority has recognised the additional pressures which the earlier closedown in 2017/18 will bring. We have been engaging with the Authority in the period leading up to the year end in order to proactively address issues as they emerge.

The Authority has strengthened its financial reporting by finalising the accounts in a slightly shorter timescale despite its financial system migration exercise and restructuring exercise in the final quarter increasing pressures on finance staff. This puts the Authority in a good position to meet the new 2017/18 deadline. Nonetheless, there is scope to improve the process, in particular in relation to dealing with outstanding audit evidence and accounts changes after the audit evidence, as the deadlines next year will be significantly tighter.

We consider the Authority's accounting practices to be appropriate.

Completeness of draft accounts

We received a complete set of draft accounts in advance of 30 June 2017, which is the statutory deadline.

Quality of supporting working papers

We issued our *Accounts Audit Protocol 2016/17* ("Prepared by Client" request) ,which outlines our documentation request. This helps the Authority to provide audit evidence in line with our expectations.

We worked with management to ensure that working paper requirements are understood and aligned to our expectations. This has generally resulted in mostly good-quality working papers with clear audit trails, and hopefully the process should be easier next year with only one system to audit.

Response to audit queries

Officers generally dealt with our audit queries swiftly although we experienced some delays in certain areas, in particular queries relating the payroll data provided by the outsourced payroll provider, and reconciliations of data extracts from the old financial system.

There is still room for improvement in this area, in particular to ensure there is sufficient audit responsibility spread around the finance team to avoid delays due to requests building up with key individuals from multiple auditors, which are a risk when the deadlines are shortened and our audit visit will require more staff over a shorter period.

Group audit

To gain assurance over the Authority's group accounts, we performed a desktop review over the group's only other entity, the Airport company which is a joint venture with Cheltenham BC.

The focus of this review was on the valuation of properties as the I&E account is immaterial to the Council.

The Council has recognised a prior period adjustment within its group account resulting from the conversion of the Airport company to new UK GAAP accounting standards (FRS 102) which has resulted in the recognition of certain material deferred tax balances. This is detailed in the relevant note to the accounts.

We consider the treatment of this adjustment and we have made some recommendations to improve related disclosures in the accounts.

There are no other specific matters to report pertaining to this review and we are also pleased to report that there were no issues to note in relation to the consolidation process.

Controls over key financial systems

We have tested controls as part of our focus on significant audit risks and other parts of your key financial systems on which we rely as part of our audit. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

Based on the work performed, and that performed by Internal Audit where we have relied on their work, we are satisfied that the controls are performing effectively. We are able to place reliance on the Authority's control framework.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's 2016/17 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 2017, 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 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 Section 151 officer for presentation to the Audit 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 other 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 2016/17 financial statements.

Section two

Value for money

Our 2016/17 VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We have concluded that the Authority has made proper arrangements to ensure it took properly-informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

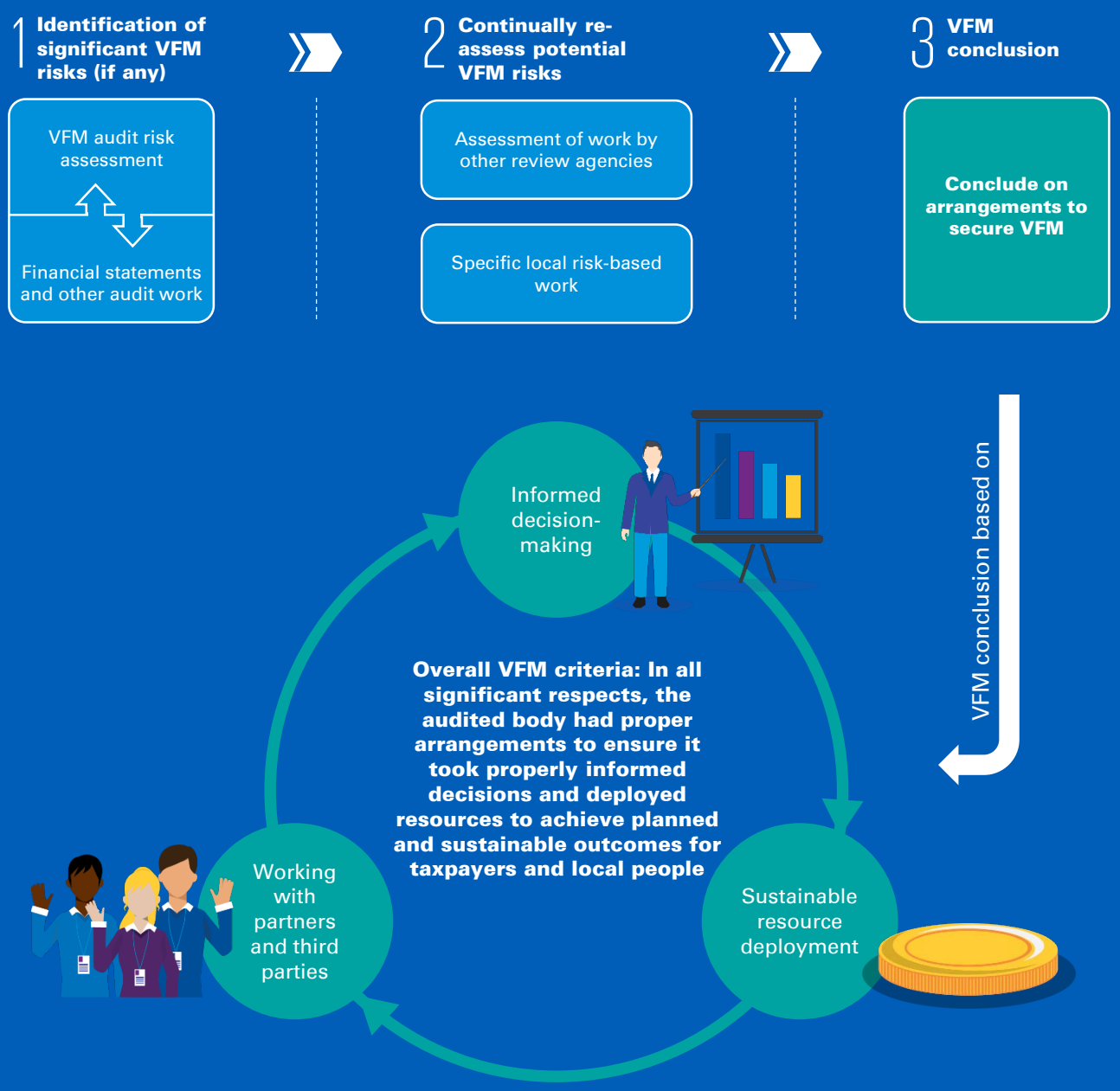
VFM conclusion

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to cause the auditor to reach an inappropriate conclusion on the audited body's arrangements.'

Our VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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



The table below summarises our assessment of the individual VFM risks identified against the three sub-criteria. This directly feeds into the overall VFM criteria and our value for money opinion.

VFM assessment summary

VFM risk	Informed decision-making	Sustainable resource deployment	Working with partners and third parties
1. Achievement of savings plan	✓	✓	n/a
2. Together Gloucester Project	✓	✓	n/a
3. Adequacy of contract monitoring	✓	n/a	n/a
4. Performance management reporting	✓	n/a	n/a
Overall summary	✓	✓	n/a

In consideration of the above, we have concluded that in 2016/17, the Authority has made proper arrangements to ensure it took properly-informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We do however note that the Council has been developing its new performance management reporting system for over twelve months now, during which time the reporting of KPIs to members has been informal and sporadic.

Although the Council has evidenced that this reporting does still occur, we recommend that this new system is implemented as a matter or urgency now that the new Council structure is finalised, so that members are clearly and regularly informed about the Council's non-financial performance levels.

Further details on the work done and our assessment are provided on the following pages.

Significant VFM risks

We have identified four significant VFM risks, as communicated to you in our *2016/17 External Audit Plan*. In all cases 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.

Significant VFM risks	Work performed
1. Financial resilience in the local and national economy	**Why is this a risk?** There has been a significant shift in the national outlook over the last 12 months, primarily driven by the outcome of the referendum on 23 June 2016 on the UK's membership of the European Union. Consequently GDP growth forecasts have been revised downwards, which potentially reduces the level of any growth in business rates income. Inflationary pressures, service pressures, and a reduction in the local government finance settlement will impact on the Authority's finances. In February 2017, the Authority published a draft money plan 2017/18 –2021/22 that sets out a balanced budget for 2017/18. From 2018/19, the Authority has identified funding gaps; however it is confident that the targets in the Efficiency Plan are sufficient to bridge the forecast gap in the money plan and are monitored by the management team. **Summary of our work** Like most of local government, the Authority faces a challenging future driven by funding reductions and an increase in demand for services. The Authority reported an overall breakeven position on its net expenditure budget for 2016/17 after the net contribution of £4.5 million from the Earmarked General Fund reserve. This enabled the General Fund balance to remain at £5.5 million as of 31 March 2017. The Authority's money plan details a balanced budget for 2017/18 including savings of £1,649,000 in year, all of which have been identified. However, the money plan details the increasingly difficult financial challenges faced each year, with further future savings which have yet to be identified of £1.2m million by 2020/21.

Significant VFM risks	Work performed
2. Together Gloucester Project	**Why is this a risk?** The Together Gloucester project will result in a fundamental restructuring of the Council's processes and teams. The project has been ongoing this year using staff from across the Council to reassess the Council's activities and the results were announced to staff in late 2016; the new structure resulting from the project has been implemented by 1 April 2017. Given the fundamental nature of this project and impact on the Council (plus the reliance of the savings plan on the project), there is an inherent VFM risk to be considered, in particular relating to the arrangements to achieve VFM within the project (e.g. governance and clarity of decision making). **Summary of our work** We have reviewed the approach followed by the Authority in considering restructuring options and providing information to members in order to allow informed decision making. In particular, our review focused on the governance processes followed and understanding whether the savings estimates were robustly calculated, via a discussion with relevant officers and review of relevant documentation. Our work found the governance processes to be reasonable and the information provided to members to be sufficiently detailed to allow informed decision making.
3. Adequacy of contracts monitoring	**Why is this a risk?** A recent internal audit report into the Streetcare contract identified a number of issues relating to the adequacy of contract monitoring, for example around monitoring of elements of cost, lack of strategy or quality related KPIs and accuracy of performance reporting from the contractor. As a result of this report, officers have established an action plan to address the issues raised. **Summary of our work** We took account of Internal Audit's work and the Council's progress against the action plan to consider the significance of the identified issues and the steps being taken to address them. We also considered the Council's other major outsourced contracts via discussion and document review to understand the level of contract monitoring. We found that the two other significant contracts, Civica Housing Benefits and IT, had established monitoring processes and KPIs. Regarding the Streetcare contract, some of the recommendations have yet to be fully implemented or resolved, but there is evidence that the Council has implemented or commencing the implementation of the majority of recommendations in the report. In addition, the Council is currently re-negotiating the KPIs and other performance monitoring controls in the contract in order to enable more robust contract management procedures to be followed (although we note that this will require the agreement of the supplier in the form of a contract variation of extra-contractual agreement). Overall, whilst recognising the need for some improvement, particularly in relation to the Streetcare contract we consider the council's contract monitoring to be sufficient to meet the VFM criteria.

Significant VFM risks	Work performed
4. Performance management reporting	**Why is this a risk?** Within our report to the Committee detailing findings from our 2015/16 audit, we noted that the Council's historical approach of reporting on service performance to Members was stopped during 2015/16. This was a deliberate decision to allow the approach to be reviewed and refined to better meet the needs of the Council, and Members and officers have continued to receive alternative information to allow performance monitoring. We noted at the conclusion of last year's audit that a revised approach was under development by the Council, and that it would be important to introduce the new approach as soon as possible to allow timely and effective monitoring to take place. **Summary of our work** We have discussed the Council's progress on implementing a new performance management approach with officers and reviewed evidence of alternative arrangements to allow monitoring while the plan is in development. The Council has delayed the implementation of a revised KPI package to be reported to members due to changes to the operating and management structure of the Council to be brought about under the Together Gloucester project. As such, there has been no formal reporting of KPIs to members for over 12 months. During this period, there is evidence of monitoring of KPIs at an officer level and periodic reporting of some KPIs to members but this has not been formalised in terms of frequency or level of reporting. The introduction of the new performance management system, Covalent, in May 2017, is intended to facilitate a new process and more effective and proactive performance management, with monitoring arrangements based on specific key projects, rather than the very extensive package of KPIs previously presented, which members had found difficult to digest due to its size. Based on our discussions and review of documentation, we consider that there is a level of performance management being performed and it is clear the Council is taking appropriate measures to implement an improved new system. We recommend that this new system is implemented as a matter or urgency now that the new Council structure is finalised, so that members are clearly and regularly informed about the Council's non-financial performance levels.

Appendices

Appendix 1

Key issues and recommendations

Our audit work on the Authority's 2016/17 financial statements have identified recommendations that we have listed in this appendix together with our recommendations which we have agreed with Management. We have also included Management's responses to these recommendations.

The Authority should closely monitor progress in addressing the risks, including the implementation of our recommendations. We will formally follow up these recommendations next year.

Each issue and recommendation have been given a priority rating, which is explained below.

High priority — 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.

Medium priority — 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.

Low priority — Issues that would, if corrected, improve internal control in general but are not vital to the overall system. These are generally issues of good practice that we feel would benefit if introduced.

The following is a summary of the issues and recommendations raised in the year 2016/17.

2016/17 recommendations summary

Priority	Total raised for 2016/17
High	**1**
Medium	**0**
Low	**0**
Total	**1**

High priority

1. Performance management reporting

The Council has been developing its new performance management reporting system for over twelve months now, during which time the reporting of KPIs to members has been informal and sporadic.

Recommendation

Implement the new performance management system as a matter of urgency, so that Members are clearly and regularly informed about the Council's non-financial performance levels.

The new system should then be drawn upon when considering the range of non-financial performance indicators that could be incorporated into the Narrative Report in the future, in line with the requirements of the Accounts & Audit Regulations 2015.

Management Response

Accepted

Implementation of new Performance Management System has commenced and will be completed before end of 2017/18

Owner

Head of Policy & Resources

Deadline

March 2018

Appendix 2

Audit differences

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 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.

A number of minor amendments focused on presentational improvements have also been made to the 2016/17 draft financial statements. The Finance team is committed to continuous improvement in the quality of the financial statements submitted for audit in future years.

Adjusted 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 2017. In addition, a number of presentational improvements were made, the most significant of which related to the new Expenditure and Funding Analysis which was updated to reconcile more clearly to the final outturn presented to members.

Table 1: Adjusted audit differences (£'000)

No.	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Basis of audit difference
1	Cr tax expense (£285k)	Dr tax through OCI £285k				The share of income taxes for the joint venture was misstated in the original draft accounts, as the taxation line in the Group Comprehensive Income and Expenditure Statement (CI&ES) was booked as an expense instead of a tax credit to the joint venture (Gloucestershire Airport Limited). The total tax recognised within the Airport CI&ES is actually a tax credit as a result of reversal of deferred tax timing differences in relation to the revaluation of the Airport's property assets. The other side of the correction was to the deferred tax movement recognized in other comprehensive income (OCI) relating to the defined benefit pension scheme, which was also stated incorrectly as a result of the error. Management adjusted for the difference and updated the accounts to reflect correctly within the Group comprehensive income and expenditure statement.
	(£285k)	**285k**	**-**	**-**	**-**	**Total impact of adjustments**

Unadjusted audit differences

The following table sets out the uncorrected audit differences identified by our audit of [name of Authority]'s financial statements for the year ended 31 March 2017. These differences are individually below our materiality level of £1.6m. Cumulatively, the impact of these uncorrected audit differences is £833k. We have also considered the cumulative impact of these unadjusted audit differences on the Authority's financial statements in forming our audit opinion.

Table 2: Unadjusted audit differences (£'000)

No.	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Basis of audit difference
1	Dr staff costs £833k	Cr General fund £833k Dr capital receipts reserve £833k		Cr provisions £833k		No restructuring provision has been recognized for the Together Gloucester project. As the formal plan consultation had been announced to all staff prior to the balance sheet date, which raised an valid expectation in them that the Council would carry the plan out, we consider that the requirement to recognize a restructuring provision under IAS 37 have been met. This cost is to be funded by capital receipts as agreed and approved by a capitalisation direction by DCLG so our adjustment recognises this within the Movement in reserves statement.
	Dr £833k	**-**	**-**	**Cr £833k**	**-**	**Total impact of uncorrected audit differences**

Appendix 3

Materiality and reporting of audit differences

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 2016/17, presented to you in March 2017.

Materiality for the Authority's accounts was set at £1.6 million which equates to around 1.6 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit 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 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 £0.080 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 Committee to assist it in fulfilling its governance responsibilities.

Appendix 4

Declaration of independence and objectivity

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

> *"The auditor should carry out their work with integrity, objectivity and independence, and in accordance with the ethical framework applicable to auditors, including the ethical standards for auditors set by the Financial Reporting Council, and any additional requirements set out by the auditor's recognised supervisory body, or any other body charged with oversight of the auditor's independence. The auditor should be, and should be seen to be, impartial and independent. Accordingly, the auditor should not carry out any other work for an audited body if that work would impair their independence in carrying out any of their statutory duties, or might reasonably be perceived as doing so."*

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 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 LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Partners and staff annually confirm their compliance with our Ethics and Independence Manual including in particular that they have no prohibited shareholdings.

Our Ethics and Independence Manual is fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through: Instilling professional values, Communications, Internal accountability, Risk management and Independent reviews.

We would be happy to discuss any of these aspects of our procedures in more detail.

Auditor declaration

In relation to the audit of the financial statements of Gloucester City Council for the financial year ending 31 March 2017, 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 Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Non-audit work and independence

Below we have listed the non-audit work performed and set out how we have considered and mitigated (where necessary) potential threats to our independence.

Summary of non-audit work		
Description of non-audit service	**Estimated fee**	**Potential threat to auditor independence and associated safeguards in place**
Housing Benefits	£10,000 (including fee variations for additional testing due to prior year errors)	**Self-interest**: The audit fee scale rates were set independently to KPMG by the PSAA and are not material to the audit fee. Therefore, the proposed engagement will have no perceived or actual impact on the audit team and the audit team resources that will be deployed to perform a robust and thorough audit. **Self-review:** The work is to provide a certification and does not provide any accounting decisions or advice that would require as part of the financial statements audit. **Management threat:** No decisions or advice to be provided as part of this work, as it is an audit related certification. **Familiarity**: This threat is limited given the scale, nature and timing of the work. **Advocacy**: We will not act as advocates for the Authority in any aspect of this work. **Intimidation**: not applicable
Total estimated fees	**£10,000**	
Total estimated fees as a percentage of the external audit fees	**16%**	

Appendix 5

Audit fees

Audit fees

As communicated to you in our External Audit Plan 2016/17, our scale fee for the audit is £63,450 plus VAT, which is the same as the prior year.

However, we have been required to perform additional work compared to the scale fee work in relation to the change in financial system and also in relation to the specific VFM risks which were subject to audit during the year as detailed on page 18 (excluding the savings plan VFM risk which is included in the scale fee). The proposed fee variations in relation total an additional £7,041 plus VAT. These fees have been discussed with the S151 officer and are subject to PSAA determination.

Our work on the certification of Housing Benefits (BEN01) is not yet complete. The planned scale fee for this is £7,043 plus VAT, although the final fee is likely to be higher as a result of additional testing that is required due to errors identified in previous years' certifications.