KPMG

External Audit ISA260 Report 2017/18

Gloucester City Council

—

17 July 2018

Summary for Audit & Governance Committee

This document summarises the key findings in relation to our 2017-18 external audit at Gloucester City Council ('the Authority').

This report covers both our on-site work which was completed in February and June to July 2018 on the Authority's significant risk areas, as well as other areas of your financial statements, and the control environment in place to support the production of timely and accurate financial statements.

Organisational and IT control environment	We consider that your organisational controls are effective overall with areas for improvement noted in specific areas as set out on page 4.
Controls over key financial systems	Based on our work, and the work of your internal auditors, we have determined that the controls over the key financial systems are generally sound.
Review of internal audit	We did not identify any significant issues with internal audit's work and are pleased to report that we are again able to place full reliance on internal audit's work on the key financial systems.
Accounts production	The accounts were successfully produced to meet faster close deadlines.
Financial statements	**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 31 July 2018.** Based upon our initial assessment of risks to the financial statements (as reported to you in our *External Audit Plan 2017/18* and updated during our audit) we identified the following significant risks (excluding those mandated by International Standards on Auditing – see Page 11): — **Valuation of Property Plant & Equipment (PPE)** – We determined that the year-end valuations of PPE are reasonable (with one area to be finalised at the time of writing as detailed on page 11); — **Pensions Liabilities** – We determined that the assumptions and methodology used by the scheme actuary were in totality appropriate and the asset valuation and allocation was reasonable; — **Faster Close** – The faster close deadline was successfully achieved; and — **Major capital transactions** – During 2017/18, the Council entered into a significant transaction to dispose of its freehold interest in the majority of the King's Walk shopping centre and enter into a finance lease for the wider asset. This was a highly complex transaction with unclear accounting requirements so significant research was required by the finance and audit teams prior to and after the preparation of the Authority's financial statements to identify the required accounting treatment. Some aspects of the accounting treatment were not settled when the draft accounts were prepared which has meant that material changes have been made which are reflected in the final version of the accounts. The Council had not considered the detailed accounting implications of the transaction or sought external accounting advice at the time it was entered into, so we have made a recommendation about the importance of doing so on major complex transactions in the future.

Summary for Audit & Governance Committee (cont.)

Financial statements (continued)

Overall our audit work has identified four audit adjustments (see page 19 for details).

Based on our work, we have raised three recommendations which are set out in Appendix 1.

We are now in the completion stage of the audit although we do have a small number of outstanding queries and audit areas to conclude on at the time of writing, in particular finalisation of our work over fixed asset valuations and depreciation, Council Tax income and Housing Benefits. We will provide a verbal update on this at the Committee.

We will provide our Annual Audit Letter in advance of the 31 August deadline.

Value for money arrangements

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.

We set out our assessment of those areas requiring additional risk based work in our *External Audit Plan 2017/18* and have updated this assessment throughout our audit. As a result of this we have identified the following significant VFM audit risks:

- **Delivery of Budgets** – The Authority delivered a small overspend against the 2017/18 budget and made good progress in developing medium term savings plans, although uncertainty remains for beyond the five year plan.
- **Performance management** – The Pentana performance measurement system is now active and Key Performance Indicators are to be published annually.
- **Major Capital Transactions** – King's Walk Shopping Centre deal was conducted with a strong focus on the long term commercial considerations and demonstrated sound principles of governance in decision making. However, as noted above, the absence of any consideration of the accounting treatment of the transaction was a notable omission, with the ultimate accounting treatment impacting on the timing through which the financial incentives of the deal are to be recognised.

See further details on page 22.

Exercising of audit powers

We have a duty to consider whether to issue a report in the public interest about something we believe the Authority should consider, or if the public should know about.

We have not identified any matters that would require us to issue a public interest report.

In addition, we have not had to exercise any other audit powers under the Local Audit & Accountability Act 2014.

Acknowledgements

We would like to take this opportunity to thank officers and Members for their continuing help

Section one

Control Environment

Organisational control environment

We have identified no significant issues with the Authority's organisational control environment and consider that the overall arrangements that have been put in place are reasonable.

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.

Key findings

We consider that your organisational controls are effective overall. We have noted an area for improvement in relation to the Kings' Walk transaction as below, for which we recommend engaging accounting advice when entering into a similarly complex transaction in the future.

This is set out in more detail in Appendix 1.

Aspect of controls	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	2
Communications	3
Monitoring of controls	3

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

Controls over key financial systems

The controls over key financial systems are sound.

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.

Where we have determined that this is the most efficient audit approach to take, we evaluate the design and implementation of the control and then 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 your 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.

Key findings

Based on our work, and the work of your internal auditors, we have determined that the controls over all of the key financial systems are sound.

We did note a minor area for improvement with relation to unreconciled items on the fixed asset register reconciliation (see Appendix 1) but this does not impact on the effective operation of the overall control.

Aspect of controls	Assessment
Property, Plant and Equipment	3
Cash and Cash Equivalents	3
Pension Assets and Liabilities	3
Non pay expenditure	3
Payroll	3
Housing benefits expenditure	3
Business rates income	3
Council tax income	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

Following our assessment of Internal Audit, we were able to place reliance on their work on the key financial systems.

Background

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. Additional guidance for local authorities is included in the Local Government Application Note on the PSIAS.

Work completed

The scope of the work of your internal auditors and their findings informs 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 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 (ISA610) require us to complete an overall assessment of the internal audit function and to evaluate and test aspects of their work.

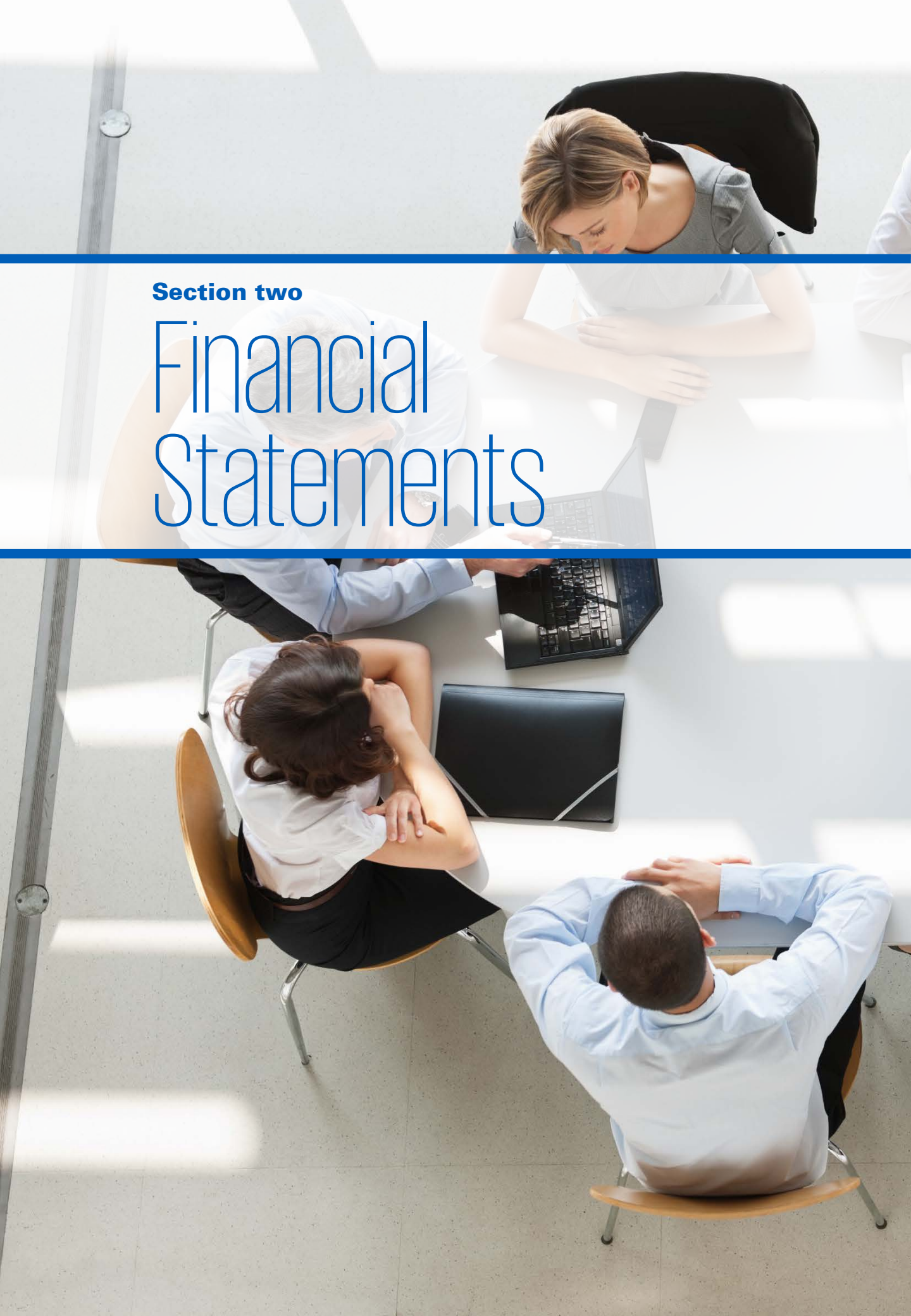
The Public Sector Internal Audit Standards define the way in which the internal audit service should undertake its functions. Internal audit completed a self-assessment against the PSIAS in February 2018.

We reviewed internal audit's work on the key financial systems and re-performed a sample of tests completed by them. We only review internal audit work that has relevance to our audit responsibilities, to effectively scope out other internal audit work from our findings. Our review of internal audit work does not represent an external review against PSIAS, as required at least every five years.

Key findings

Based on the self-assessment performed by internal audit, our assessment of their files, attendance at Audit & Governance Committee and regular meetings during the course of the year, we have not identified any significant issues which would prevent us from relying on internal audit's work for 2017/18.

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



Section two

Financial Statements

Accounts production and audit process

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.

The Authority's overall process for the preparation of the financial statements is adequate.

The Authority has implemented all of the recommendations in our *ISA 260 Report 2016/17*.

Accounts practices and production process

The Authority incorporated a number of measures into its closedown plan to continue to improve the project management of this complex process in order to meet the faster close deadline of 31 May for draft accounts and 31 July for signed accounts. The year-end preparation and audit process was unfortunately unavoidably impacted by the level of available staff due to illness, but the Authority recognised the additional pressures which the earlier closedown brought, particularly with a reduced staff availability, in order to still meet the statutory deadline. Our significant risk outlined on page 13 provides further commentary.

We consider that the overall process for the preparation of your financial statements is adequate.

We also consider the Authority's accounting practices appropriate, although we have recommendations for improvement regarding complex transactions on page 28.

Going concern

The financial statements of the Authority have been prepared on a going concern basis. We confirm that we have identified no significant matters which would, in our view, affect the ability of the Authority to continue as a going concern.

Further commentary on the Authority's arrangements in place to secure the effective delivery of budgets is included at page 25.

Completeness of draft accounts

We received a complete set of draft accounts on 31 May 2018, which is the statutory deadline.

Quality of supporting working papers

We issued our Accounts Audit Protocol to the Head of Policy and Resources in January 2018. This important document sets out our audit approach and timetable. It also summarises the working papers and other evidence we require the Authority to provide to support our audit work. This helps the Authority to provide audit evidence in line with our expectations.

Response to audit queries

In general, the time taken by officers to deal with our audit queries was good, although in some cases it did take longer than anticipated, in part due to unavoidable circumstances with staff availability and the added complexity of the King's Walk accounting, and also for certain queries fielded by officers outside of the core finance team.

However, the Finance Manager and Head of Policy and Resources responded as quickly as possible to all queries, enabling progress to be made by the audit team.

Accounts production and audit process (cont.)

Collection fund balances

The Collection Fund balance is in deficit overall by £508k, as a result of the Business Funds element of the fund, which has a deficit of £2.2m.

This deficit has decreased during 2017/18, with a £2.1m decrease in the business rates deficit from its starting position of £4.3m deficit.

The Council Tax element of the fund has made a surplus of £0.6m this year and remains in credit overall of £1.7m.

The Authority is applying established processes to recover the deficit in future years. No issues have been identified in our review of the accounting of either part of the fund.

Specific audit areas

We anticipate issuing an unqualified audit opinion on the Authority's 2017-18 financial statements by 31 July 2018.

For the year ending 31 March 2018, the Authority has reported a surplus of £0.432m. The impact on the General Fund has been an increase of £0.432m. The Authority has used £1.137m of capital receipts against its revenue expenditure. The underlying surplus before the use of capital receipts is £0.783m.

Auditing standards require us to consider two standard risks for all organisations. We consider these as a matter of course in our audit and will have set out the findings arising from our work in our ISA 260 Report below.

01

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.

02

Fraudulent 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 2017-18* 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.

Over the following pages we have set out our assessment of the specific significant risks and areas of audit focus we identified in relation to the audit of the Authority's financial statements.

Specific audit areas

Significant Audit Risks – Authority

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error in relation to the Authority.

Risk:	**Valuation of PPE** The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Authority has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle. As a result of this, however, individual assets may not be revalued for four years. This creates a risk that the carrying value of those assets not revalued in year differs materially from the year end fair value.
Our assessment and work undertaken:	We reviewed the approach that the Authority adopted to assess the risk that assets not subject to valuation were materially misstated and considered the robustness of that approach. In addition, we considered movements in valuation between revaluation dates of assets not revalued in year and the year end in order to determine whether these indicate that fair values had moved materially over that time. Work on this area is still to be finalised at the time of writing. In relation to those assets which have been revalued during the year we reviewed the accounting entries made to record the results of the revaluation in order to ensure that they were appropriate. We also assessed the valuer's qualifications, objectivity and independence to carry out such valuations and reviewed the methodology used (including testing the underlying data and assumptions). As a result of this work we determined that the valuations of PPE are reasonable. We have set out our view of the assumptions used in relation to accounting for Property, Plant & Equipment at page 18.

Specific audit areas (cont.)

Significant Audit Risks – Authority (cont.)

Risk:

Pension Liabilities

The net pension liability represents a material element of the Authority's balance sheet. The Authority is an admitted body of Gloucestershire County Council Local Government Pension Scheme, which had its last triennial valuation completed as at 31 March 2016. This forms an integral basis of the valuation as at 31 March 2018.

The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Authority's overall valuation.

There are financial assumptions and demographic assumptions used in the calculation of the Authority's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should also reflect the profile of the Authority's employees, and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes.

There is a risk that the assumptions and methodology used in the valuation of the Authority's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements.

Our assessment and work undertaken:

As part of our work we reviewed the controls that the Authority has in place over the information sent directly to the Scheme Actuary. We also liaised with the auditors of the Pension Fund in order to gain an understanding of the effectiveness of those controls operated by the Pension Fund. This included consideration of the process and controls with respect to the assumptions used in the valuation. We also evaluated the competency, objectivity and independence of Hymans Robertson, the Scheme Actuary.

We reviewed the appropriateness of the key assumptions included within the valuation, compared them to expected ranges and involved a KPMG Actuary to provide a specialist assessment of those assumptions. We also reviewed the methodology applied in the valuation by Hymans Robertson, the Pension Fund's actuary.

In addition, we reviewed the overall actuarial valuation and considered the disclosure implications in the financial statements.

In order to determine whether the net pension liability has been appropriately accounted for we also considered the valuation of pension assets. We obtained assurance from the Pension Fund auditors (Grant Thornton) over the overall value of fund assets. We then liaised with the actuary to understand how these assets are allocated across participating bodies and re-performed this allocation.

As a result of this work we determined that the assumptions and methodology used by the scheme actuary were in totality appropriate and the asset valuation and allocation was reasonable. We have set out our view of the assumptions used in valuing pension assets and liabilities at page 19.

Specific audit areas (cont.)

Significant Audit Risks – Authority (cont.)

Risk:

Faster Close

In prior years, the Authority has been required to prepare draft financial statements by 30 June and then final signed accounts by 30 September. For years ending on and after 31 March 2018 however, revised deadlines apply which require draft accounts by 31 May and final signed accounts by 31 July.

During 2016/17, the Authority continued its preparation for these revised deadlines and advanced its own accounts production timetable. Whilst this was an advancement on the timetable applied in preceding years, further work is still required in order to ensure that the statutory deadlines for 2017/18 are met, including ensuring that all audit queries and accounts updates are resolved in accordance with the new deadline for signing.

In order to meet the revised deadlines, the Authority may need to make greater use of accounting estimates. In doing so, consideration will need to be given to ensuring that these estimates remain valid at the point of finalising the financial statements. In addition, there are a number of logistical challenges that will need to be managed. These include:

- Ensuring that any third parties involved in the production of the accounts (including valuers and actuaries) are aware of the revised deadlines and have made arrangements to provide the output of their work in accordance with this;
- Revising the closedown and accounts production timetable in order to ensure that all working papers and other supporting documentation are available at the start of the audit process;
- Ensuring that the Audit & Governance Committee meeting schedules have been updated to permit signing in July; and
- Applying a shorter paper deadline to the July meeting of the Audit & Governance Committee meeting in order to accommodate the production of the final version of the accounts and our ISA 260 report.

In the event that the above areas are not effectively managed there is a significant risk that the audit will not be completed by the 31 July deadline.

There is also an increased likelihood that the Audit Certificate (which confirms that all audit work for the year has been completed) may be issued separately at a later date if work is still ongoing in relation to the Authority's Whole of Government Accounts return. This is not a matter of concern and is not seen as a breach of deadlines.

Our assessment and work undertaken:

We liaised with officers in preparation for our audit in order to understand the steps that the Authority was taking in order to ensure it met the revised deadlines. We also advanced audit work into the interim visit in order to streamline the year end audit work.

We received draft financial statements on the statutory deadline of 31 May 2018. The quality of this draft was reasonably consistent with that of prior years.

Specific audit areas (cont.)

Significant Audit Risks – Authority (cont.)

Risk:

Major capital transactions

The Council had two major capital projects / transactions during the year; the first being the redevelopment of King's Walk shopping centre and the second relates to the new bus station. Both transactions are material to the accounts and are potentially complex and therefore at increased risk of error. In particular, we understand that the shopping centre transaction involved a number of elements including the sale and lease back of capital assets which have specific accounting considerations, as well as other funding contributions.

Our assessment and work undertaken:

We have reviewed both transactions and considering the accounting against relevant accounting standards.

The bus station is a relatively simple capital development and we have performed work over additions to check that these are accurately accounted for.

However, the King's Walk shopping centre transaction has been very complex to account for and to audit due to the multifaceted nature of the transaction.

In essence, the Council entered into an agreement in July 2017 with two third parties to dispose of its freehold in specific parts of the shopping centre, and take out two finance leases (initial and reversionary) lasting in total 45 years over the whole of the shopping centre, including units in which the Council previously had no freehold interest.

The Council received no consideration for the disposal (which had a £3.6m carrying value at the transaction date), but within the lease the Council received number of payments of different definitions totalling £19.8m as set out below. The ongoing leasing costs to the Council are £1.4m per annum increasing by RPI each year, with an option to purchase the freehold for a peppercorn amount at the end of the lease.

Funding	Value (£)
Deposit for Capital Works	4,675,000
Rent Guarantee 1	3,055,000
Rent Guarantee 2	1,725,000
Initial Rent	4,370,240
SDLT	500,000
Sinking Fund	5,500,000
TOTAL	**19,825,240**

Officers presented their initial proposed accounting treatment to us for review in March 2018, based on an internal assessment prepared by Finance staff at our request. This treatment proposed to recognise the majority of receipts except for the £4.78m deposit for capital works as income in 2017/18, with the capital receipts to be recognised in line with related capital expenditure. The lease was to be recognised on the balance sheet with an asset and a valuation of c£62m, with the asset subsequently being impaired to the fair value of the lease interest now held by the Council, being £2.9m based on an external valuation.

After consideration of this treatment and review of the legal documentation, we concluded the transaction was not a sale and leaseback because the assets involved differed, and as such, the Council was correct in this treatment. However, the treatment of cash receipts was not appropriate, as the cash received on entering into the lease constituted lease incentives which we would expect to be deducted from the cost of the asset. Given the complexity and level of judgement involved, we recommended that management sought expert accounting advice at a matter of urgency, given that this was not received at the time of entering into the contractual agreement. (continued overleaf)

Specific audit areas (cont.)

Significant Audit Risks – Authority (cont.)

Risk: **Major capital transactions (continued)**

Our assessment and work undertaken (continued):

As a result of this, the Council sought accounting advice from Grant Thornton (GT), and in the meantime updated its accounting treatment to spread the initial rent and sinking fund elements totalling £9.8m over the life of the lease. It is this treatment that was adopted in the draft accounts, which were drafted before advice was received from GT.

GT's advice was received in June 2018, following which the Council prepared a revised accounting proposal, both of which were received by KPMG on 25 June 2018.

This agreed with the KPMG judgement that the transaction is not a sale and leaseback and also concluded that the majority of cash receipts were lease incentives. GT correctly stated that the current accounting standard, IAS 17, is silent on how incentives should be accounted for under a finance lease, so the paper recommended that management apply reasonable judgement to this. Management's subsequent judgement is that all payments will be deducted from the value of the asset other than the capital works deposit (£4.6m) which remain recognised in line with related spend, and the two rental guarantees (£4.78m) which are intended to guarantee certain elements of the rent over a period of five years and calculated as such, and so will be recognised as income over a five year period. In addition, there is a SDLT funding element of £0.5m which has been treated as income in 2017/18 in line with the SDLT payment.

KPMG has considered this and on balance we are content that management's judgement is reasonable and the accounting treatment in line with extant accounting standards. We note that there are aspects of the contractual clause in the lease regarding the rental guarantees that do not necessarily support the judgement, notably that there are no circumstances under which the Council has to repay any of the rental guarantee incentives even if occupancy exceeds the levels assumed in the calculations, which might point more towards these being treated as lease incentives from the asset. However, the fact that the rental guarantee amounts were calculated using occupancy levels does provide some support to the judgement.

One issue not considered in detail by Grant Thornton is the interest rate to use in calculating the value of the lease. IAS 17 states that in the circumstances of meeting the King's Walk lease, the asset and liability should be calculated using the lessee's incremental borrowing rate of interest, which is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

The Council had judged this to be a rate of 1.73% equating to the PWLB preferential rate of borrowing, which in an asset and liability of £62m, and subsequent impairment of the asset by £54m to the external post-acquisition valuation and a net liabilities position of £24.8m in the draft accounts published on 31 May 2018.

KPMG's view is that using such a rate is not appropriate, as IAS 17 is designed for use by corporate bodies who do not have access to treasury-backed preferential borrowing rates. The standard sets out to value the lease at the value that a third party loan could be obtained using the shopping centre as security, and as such, a more appropriate rate would be the rate that could be achieved by borrowing at non-preferential rates from a third party (e.g. bank or bond).

Specific audit areas (cont.)

Significant Audit Risks – Authority (cont.)

Risk: **Major capital transactions (continued)**

Our assessment and work undertaken (continued):

The Council consulted with its treasury specialists, LINK, and determined the appropriate rate would be the secured 43 year gild rate of 5.795%, a rate which we are comfortable with. This resulted in a reduction of the initially recognised lease liability to £29m and a corresponding reduction in the asset initially recognised.

Following this advice, the Council has updated its treatment in the final year-end accounts. The final movements on the key balances in the original compared to final accounts can be seen below:

Funding	Original proposal	Draft accounts	Final accounts
Asset and liability valuation (before lease incentive deductions	£62m	£62m	£29m
Incentives to deduct from Asset Value	£0m	-£14.625m	-£9.87m
Year 1 Income	£19.8m	£5.5m	£6.456m
Impairment of asset to fair value through CI&ES	N/A	-£48.5m	-£16.9m

We have reviewed the treatment in the final accounts and consider it to be appropriate.

We acknowledge that from a commercial perspective, the King's Walk development and subsequently this deal, play a pivotal role in the regeneration of the city and offers an exciting opportunity for the modernisation of the King's Quarter area. The governance demonstrated by the Council as part of the decision making process was particularly strong. The information presented to the Cabinet to inform the deal negotiation process was accurate, reliable and supported by relevant commercial and legal advice.

However, we do have concerns about the process followed by the Council in entering into this agreement without seeking external accounting advice, and involving us in the process a significant amount of time after the agreement was signed, which has resulted.in the significant differences between the draft and year-end accounts, and particularly between the originally anticipated accounting position (prior to the draft accounts being prepared) and the final position.

We recommend that in subsequent complex transactions, the Council obtains expert accounting advice in a timely manner, preferably prior to completion of the transaction, and so that an informed proposal for accounting can be developed significantly before the year-end accounts closedown.

We also recommend that the Council monitors the proposed accounting treatment for leases when the Code adopts the new leasing standard, IFRS 16, in 2018/19, as this might have significant impact on the King's Walk lease treatment, as well as all leases held by the Council which will need equivalent valuation.

Judgements

We have considered the level of prudence within key judgements in your 2017-18 financial statements and accounting estimates. We have set out our view below across the following range of judgements.

Level of prudence

0	1	2	3	4	5	6
Audit Difference	Cautious		Balanced		Optimistic	**Audit Difference**
	Acceptable Range					

Subjective area	2017-18	2016-17	Commentary
Provisions (excluding Business Rates)	3	3	The provisions balance is immaterial at £286k. It is made up of insurance claims, legal claims, and annual leave provision. The provisions have decreased by £71k in 2017/18.
Business Rates provision	3	4	Since 2013/14 the Authority has been responsible for a proportion of successful rateable value appeals. The Council has increased its provision this year by £314k following a review of appeals.
Property Plant & Equipment	3	3	We have reviewed the asset valuations during the period and found them to be reasonable and performed using an appropriate methodology.
Kings' Walk liability valuation	4	N/A	We consider the final valuations assumptions made by management to be balanced, with judgements made in relation to the recognition of the lease incentives in line with extant accounting standards which are silent on their treatment, although more optimistic in the recognition profile proposed than the likely accounting under the future standard IFRS 16. We note that initial judgements were overly optimistic in terms of income recognition and valuation of the asset and resulted in adjustments being made to the final accounts – see page 15 to 17.

Judgements (cont.)

Subjective area	2017-18	2016-17	Commentary
Valuation of pension liabilities	3	3	The Authority continues to use Hymans Robertson to provide actuarial valuations in relation to the assets and liabilities recognised as a result of participation in the Local Government Pension Scheme. Due to the overall value of the pension assets and liabilities, small movements in the assumptions can have a significant impact on the overall valuation. For example, a 0.5% change in the discount rate would change the net liability by £13.7 million. The actual assumptions adopted by the actuary fell within our expected ranges as set our below:

Assumption	Actuary Value	KPMG benchmark	Assessment
Discount rate	2.60%	2.49%	5
Pension increase rate	2.4%	2.17%	1
Salary Growth	CPI +0.3%	CPI + 0% to 2%	3
Life expectancy Current male / female Future male / female	 22.4/ 24.6 24.0/ 26.4	 22.1/23.9 23.5/25.4	1

The overall set of assumptions proposed by the Employer can be considered to be balanced relative to our central rates for a typical UK scheme with a duration of 15.8 years and within our normally acceptable range.

Proposed opinion and audit differences

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's 2017-18 financial statements following approval of the Statement of Accounts by the Audit & Governance Committee on 23/07/2018.

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 4) for this year's audit was set at £1.9 million for the Authority. Audit differences below £95,000 are not considered significant.

A total of three significant audit differences were identified during our audit, which we set out in Appendix 3. It is our understanding that all but one will be adjusted in the final version of the financial statements.

The tables below illustrate the total impact of audit differences on the Authority's movements on the General Fund for the year and balance sheet as at 31 March 2018. The net impact on the General Fund as a result of these adjustments is £514,000.

Movement on the General Fund 2017-18

£000's	Pre-Audit	Post-Audit	Ref [1]
Deficit on the provision of services	(50,051)	(18,304)	1,2
Adjustments between accounting basis and funding basis under regulations	49,969	18,736	1
Increase/(Decrease) in General Fund	**(82)**	**432**	

[1] See referenced adjustments in Appendix 3.

Balance Sheet as at 31 March 2018

£000's	Pre-Audit	Post-Audit	Ref [1]
Property, Plant & Equipment	79,767	79,767	
Other long term assets	31,620	31,620	
Current assets	24,054	24,054	
Current liabilities	(20,529)	(23,527)	1,2
Long term liabilities	(139,748)	(105,003)	1
Net worth	**(24,836)**	**6,911**	
General Fund	5,840	6,354	1,2
Other useable reserves	4,950	4,950	
Unusable reserves	(35,626)	(4,393)	1
Total Reserves	**(24,836)**	**6,911**	

Proposed opinion and audit differences (cont.)

Annual governance statement

We have reviewed the Authority's 2017-18 Annual Governance Statement and confirmed it is consistent with other information we are aware of from our audit of the financial statements.

Narrative report

We have reviewed the Authority's 2017-18 narrative report and have confirmed that it is consistent with the financial statements and our understanding of the Authority.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's 2017/18 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 2018, 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 5 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 Head of Policy & Resources for presentation to the Audit & Governance Committee. We require a signed copy of your management representations before we issue our audit opinion.

Included in our template are specific representations that we are seeking in relation to the judgements made by management in accounting for the King's Walk transaction.

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 relating to the audit of the Authority's 2017-18 financial statements.

Section three

Value for Money Arrangements

Specific value for money risk areas

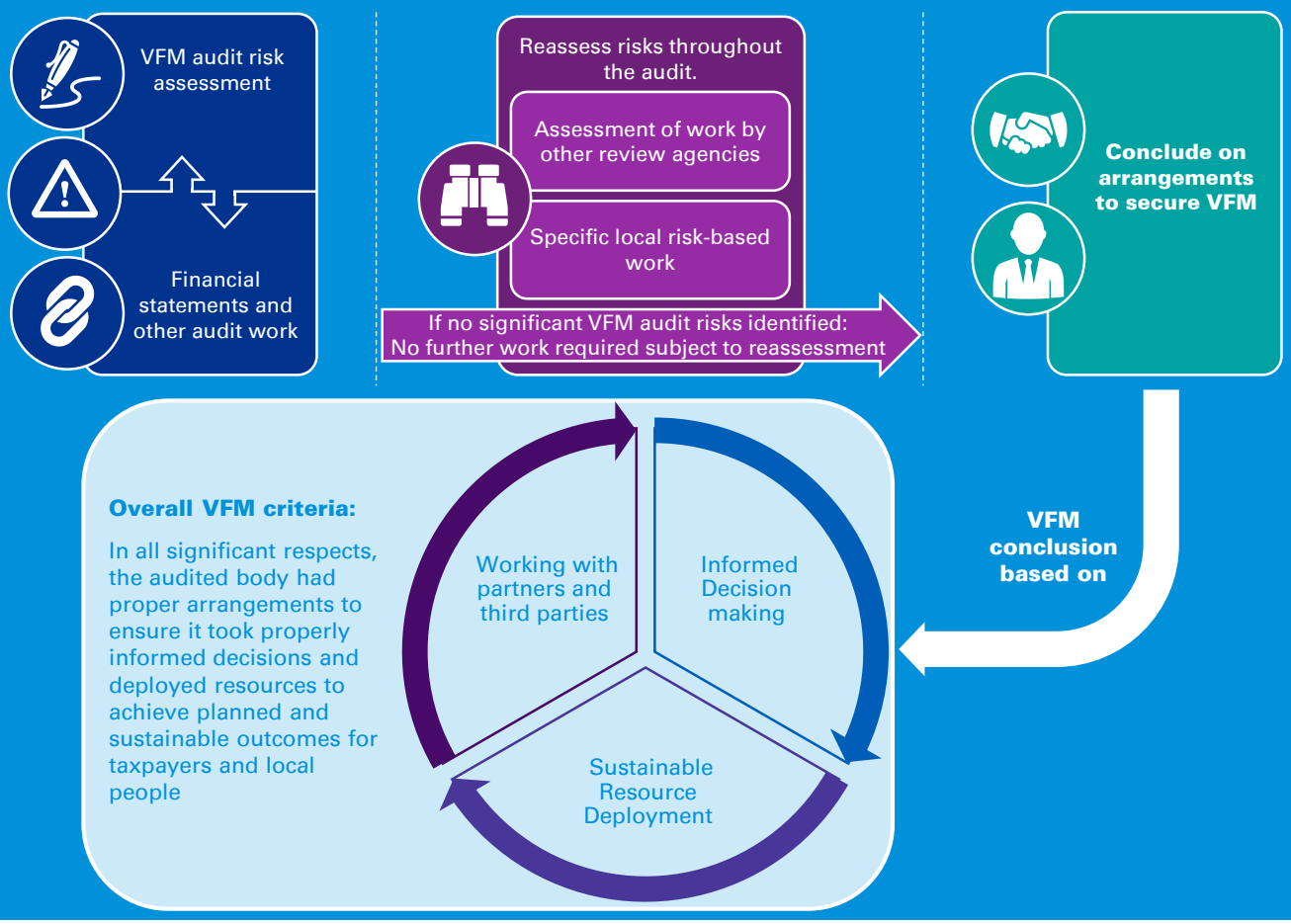
Our 2017-18 VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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.

The Local Audit & 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.'

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



Specific value for money risk areas (cont.)

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.

Applicability of VFM Risks to VFM sub-criteria

VFM Risk	Informed decision making	Sustainable resource deployment	Working with partner and third parties
Delivery of budgets	✓	✓	✓
Performance Management	✓	✓	✓
King's Walk	✓	✓	✓

In consideration of the above, we have concluded that in 2017-18, 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.

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

Specific value for money risk areas (cont.)

As communicated to you in our *External Audit Plan* 2017-18, and as updated throughout the audit, we have identified two risks requiring specific audit attention and procedures to address the likelihood that proper arrangements are not in place to deliver value for money.

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.

We have provided below a summary of the risk areas identified, our work undertaken and the conclusions reached. We have highlighted those risks which were identified after we presented our *External Audit Plan 2017/18*.

Risk:

Delivery of budgets

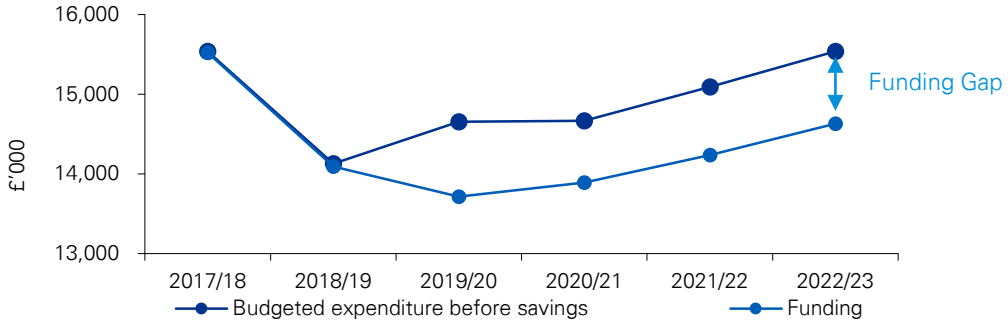
The Authority identified required savings of £1.5m and targeted savings of £1.65 million in 2017/18. The quarter 2 forecast shows that the Authority will achieve nearly all these targeted savings and deliver an overspend of approximately £164,000, the majority of which relates to a museums savings proposal which has not yet been achieved. The Council believes this forecast position may improve by the year-end as the new Council structure beds in.

The Authority's money plan for the five years from 2017/18 (approved in February 2017) recognised a need for further savings during 2018/19 and in future years, but at a significantly reduced level than 2017/18 due to the front loading of the plan; £0.5m is needed during 2018/19 and a further £0.9m in the three following years. The Council is therefore progressing well towards achieving its required savings targets, but there remains a risk due to the level of funding reductions and potential volatility in income levels and cost pressures.

Our assessment and work undertaken:

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 overspend after reserve transfers of £82,000 for 2017/18 in its draft accounts. This has changed to a £432,000 underspend in the final accounts following adjustments in the treatment of King's Walk. This enabled the General Fund balance to increase to £6.4 million as of 31 March 2018.

The Authority's medium term financial plan (MTFP) details a balanced budget for 2018/19 including savings of £37,000 million in year, all of which have been identified. However, the MTFP shows an increasingly difficult financial challenge faced each year, resulting in the need for ever rising savings, up to £1.1 million cumulatively by 2022/23. We reviewed the progress towards identifying savings and have found that the Council is making good progress towards achieving these savings, with targets front-loaded in the early years of the five year plan. While the Council has suitable arrangements in place currently, and the King's Walk transaction has resulted in medium term income to the Council reducing the saving requirements, it should continue to monitor this situation carefully, particularly with greater uncertainty over the years following the plan and as the King's Walk arrangement results in lease commitments of an approximately £101m (after inflation) over the life of the 45 year agreement.



Specific value for money risk areas (cont.)

Significant VFM Risks (cont.)

Risk:	**Performance management reporting** During our previous audits, we noted the Council's historical approach of reporting on service performance to members was stopped during 2015/16. The implementation of a revised Key Performance Indicator (KPI) package to be reported to members was planned but had not been formalised by the time of our final external audit report 2016-17 in September 2017, as the Council was awaiting the conclusion of the Together Gloucester project in order to finalise the corporate structure before KPIs were put in place. We recommended that the Council implemented 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.
Our assessment and work undertaken:	We have considered the Council's progress on implementing a new performance management approach with officers and review supporting evidence. We understood at the time of writing our audit plan that the new performance management system was to be fully implemented using the Council's newly acquired Pentana software by the end of 2017/18. This was subsequently delayed to early 2018/19 in order to allow sufficient time to ensure that the new framework was fit for purpose, but is now in place. During the 2017/18 financial year, the process in place last year remained in place, with a reduced version of the old metrics being reported internally to officers, and all significant council contracts having their own KPIs monitored by the relevant service team, and periodic reporting of some KPIs to members. Based on our discussions and review of documentation, we consider that there is a level of performance management being performed. As in 2016/17, we consider that these processes are adequate to result in an unqualified VFM opinion, but the recently introduced new system is a necessary enhancement to the arrangements that operated in 2017/18.

Specific value for money risk areas (cont.)

Significant VFM Risks (cont.)

Newly Identified Area of Risk

Risk:

King's Walk shopping centre

Our work on the King's Walk shopping centre transaction identified a number of areas of consideration regarding Value for Money, and as such, we have incorporated as an additional VFM risk since our Audit Plan.

VFM Sub-criterion:

This risk is related to the following Value For Money sub-criterion

— Informed decision making;

— Sustainable resource deployment; and

— Working with partners and third parties

Our assessment and work undertaken:

We have considered the decisions made and processes followed by the Council with regard to the risk criteria.

The deal is congruent with the Council's city regeneration plan, with the intention to achieve immediate asset management improvements and a view to the longer term financial sustainability of King's Walk.

Members were briefed and provided with suitable documentation to allow informed decision making with regard to the cash impact of the deal, as well as the risks around the level of commercial rental income required to service the lease payments. It is clear that the commercial aspects of the deal were well understood and the structure of the leases were designed to meet the Council's overall strategic aims. In addition, detailed due diligence and legal advice was obtained.

However, as noted on page 14, the development was entered into without seeking external accounting advice, and as such the decision to proceed with the transaction was made without a full and correct understanding of the financial implications, notably that all of the £19.8m of lease incentive payments were expected to be accounted for as income in 2017/18, whereas the final position is that £4.78m will be recognised over the first five years with a further £9.87m over the 45 year term of the lease agreements. This adjustment has no ultimate cash impact over the lifespan of the lease and limited budgetary impact but does impact the overall general fund position at the year-end. The Council is using earmarked reserves to smooth the impact on the unearmarked element of the fund.

Based on the level of risk assessment and the decision making process that was followed, we consider that there were sufficient positive elements to support an unqualified VFM opinion, with a recommendation raised regarding accounting advice.

Appendices

Appendix 1:

Key issues and recommendations

Our audit work on the Authority's 2017-18 financial statements has identified a number of issues. We have listed these issues 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 have given each recommendation a risk rating and agreed what action management will need to take.

Priority Rating for Recommendations

1	**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. Recommendations Raised: 1	2	**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. Recommendations Raised: 0	3	**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. Recommendations Raised: 1

No.	Risk	Issue & Recommendation	Management Response
1	1	The King's Walk shopping centre development was entered into without seeking external accounting advice, which resulted in material differences between the initial proposed treatment and the final accounts. It also meant that the decision to proceed with the transaction was made without a full and correct understanding of the financial implications, notably that all of the £19.8m of lease incentive payments were expected to be accounted for as income in 2017/18, whereas the final position is that £4.78m will be recognised over the first five years with a further £9.87m over the 45 year term of the lease agreements. ***Risk*** Incorrect consideration of accounting impact of complex transactions may result in misstatement of the Council's accounts, as well as increasing the risk of misinformed decision making should decisions be based on an incorrect accounting treatment. ***Recommendation*** Seek appropriate accounting advice in a timely manner for complex transactions.	The Council follows a comprehensive process of due-diligence in relation to all matters of significant capital acquisition. In future, where such acquisitions are likely to include accounting treatments outside of typical day to day activities, this will include consideration of the accounting treatment. ***Responsible Officer*** Jon Topping ***Implementation Deadline*** 01/08/2018

Key issues and recommendations (continued)

Priority Rating for Recommendations

1	**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. Recommendations Raised: 1	2	**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. Recommendations Raised: 0	3	**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. Recommendations Raised: 1

No.	Risk	Issue & Recommendation	Management Response
2	3	On the fixed asset register to general ledger reconciliation, there is an unsupported £2,000 difference that has been on the ledger since the system change last year. ***Risk*** If reconciling items are not investigated and adjusted, there is a risk of misstatement of the accounts. ***Recommendation*** Ensure all historic unreconciled items are investigated and written off as needed.	The Council has already eliminated nearly all historical balances from its accounts, including a complete rationalisation of the balance sheet, and 2018/19 will see the removal of this remaining minor issue. ***Responsible Officer*** Jon Topping ***Implementation Deadline*** 31/12/2018

Appendix 2:

Follow-up of prior year recommendations

The Authority has implemented all of the recommendations raised through our previous audit work.

This appendix summarises the progress made to implement the recommendations identified in *ISA 260 Report 2016/17* and re-iterates any recommendations still outstanding.

Number of recommendations that were	
Included in the original report	1
Implemented in year or superseded	1
Outstanding at the time of our interim audit	0

No.	Risk	Issue & Recommendation	Management Response	Status as at July 2018
1	1	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.	Accepted Implementation of new Performance Management System has commenced and will be completed before end of 2017/18 ***Responsible Officer*** Jon Topping – Head of Policy and Resources ***Implementation Deadline*** March 2018	The new system has now been introduced. A link to the KPI reporting is included in the Narrative Report this year.

Appendix 3:

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 & 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.

A number of minor amendments focused on presentational improvements have also been made to the 2017-18 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 2018. We have also captured one management adjustment made in order to allow reconciliation between the draft and the final accounts. The overall impact on the general fund is an increase of £514,000.

Table 1: Adjusted audit differences – Authority (£'000)

No.	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Basis of difference
1	Cr investment properties revaluation £31,601 Cr deficit on operations £495 Dr interest payable £450	Dr General Fund Adjustments between accounting basis and funding basis £31,233 Dr Capital Adjustment Account £31,233		Dr Lease liability £35,931 Cr deferred rent guarantee £4,083		Adjustments to the King's Walk shopping centre transaction to reflect the amended interest rate for the lease (reducing liability and asset value) and also reflecting the amendments in treatment to elements of the incentive payments received as set out on page 14.
2	Dr staff costs £101			Cr creditors £101		Management adjustment to book extra termination costs accrual – this was a post balance sheet event adjustment and not an audit correction.
	Cr £31,747	**-**	**-**	**Dr £31,747**	**-**	**Total impact of adjustments**

Audit differences (cont.)

Unadjusted 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 2018. These differences are individually below our authority materiality level of £1.9m. Cumulatively, the I&E impact of these uncorrected audit differences is £120k. 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 – Authority (£'000)

No.	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Basis of audit difference
1	Cr I&E £120k			Cr accruals £457k	Dr reserves £577k	The housing benefits payments overlap year-end so technically 6 days of the April payment should have been accrued at 31 March 2018. The same issue was present last year so the impact on the I&E is the net effect.
	Cr £120k	**-**	**-**	**Cr £457k**	**Dr £577k**	**Total impact of adjustments**

Presentational adjustments

We identified a number of presentational adjustments required to ensure that the Authority's financial statements for the year ending 31 March 2018 are fully compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2017-18 ('the Code'), for example incorporating all redundancy costs within the Note 34 Termination Benefits.

These adjustments were not significant and have been amended in the final version of the accounts.

Appendix 4:

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 2017-18*, issued in January 2018.

Materiality for the Authority's accounts was set at £1.9m million for the Authority and £2.0 for the Group which equates to around 2 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit & Governance 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 & Governance 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, an individual difference is considered to be clearly trivial if it is less than £95,000 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 & Governance Committee to assist it in fulfilling its governance responsibilities.

Appendix 5:

Required communications with the Audit & Governance Committee

We have provided below at-a-glance summary of the information we are required to report to you in writing by International Accounting Standards.

Required Communication	Commentary
Our draft management representation letter	We have not requested any specific representations in addition to those areas normally covered by our standard representation letter for the year ended 31 December 2018.
Adjusted audit differences	We have identified two adjusted audit differences. See Appendix 3 for details.
Unadjusted audit differences	The net impact of unadjusted audit differences on the surplus on provision of services would be nil. In line with ISA 450 we request that you adjust for these items. However, they will have no effect on the opinion in the auditor's report, individually or in aggregate. See Appendix 3 for further details.
Related parties	There were no significant matters that arose during the audit in connection with the entity's related parties.
Other matters warranting attention by the Audit & Governance Committee	There were no matters to report arising from the audit that, in our professional judgment, are significant to the oversight of the financial reporting process.
Control deficiencies	We have set out our assessment of the Authority's internal control environment, including details of significant deficiencies identified. We have also communicated to management all deficiencies in internal control over financial reporting of a lesser magnitude than significant deficiencies identified during the audit.
Actual or suspected fraud, noncompliance with laws or regulations or illegal acts	We identified no actual or suspected fraud involving the Authority's Members or officers with significant roles in internal control, or where the fraud resulted in a material misstatement in the financial statements.
Significant difficulties	No significant difficulties were encountered during the audit.
Modifications to auditor's report	There are no modifications to our audit report.
Disagreements with management or scope limitations	The engagement team had no disagreements with management and no scope limitations were imposed by management during the audit.

Appendix 5:

Required communications with the Audit & Governance Committee (cont.)

Required Communication	Commentary
Other information	No material inconsistencies were identified related to other information in the Narrative Report or Annual Governance Statement. These reports were found to be fair, balanced and comprehensive.
Our declaration of independence and any breaches of independence	No matters to report. The engagement team have complied with relevant ethical requirements regarding independence. See Appendix 6 for further details.
Accounting practices	Over the course of our audit, we have evaluated the appropriateness of the Authority's accounting policies, accounting estimates and financial statement disclosures. In general, we believe these are appropriate. We have set out our view of the assumptions used in valuing pension assets and liabilities at page 19.
Significant matters discussed or subject to correspondence with management	There were no other significant matters arising from the audit that are not set out in this report.

Appendix 6:

Declaration of independence

ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF GLOUCESTER CITY COUNCIL

Professional ethical standards require us to provide to you at the conclusion of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed.

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code of Audit Practice, the provisions of Public Sector Audit Appointments Limited's ('PSAA's') Terms of Appointment relating to independence, the requirements of the FRC Ethical Standard and the requirements of Auditor Guidance Note 1 - General Guidance Supporting Local Audit (AGN01) issued by the National Audit Office ('NAO') on behalf of the Comptroller and Auditor General.

This Statement is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

— General procedures to safeguard independence and objectivity;

— Independence and objectivity considerations relating to the provision of non-audit services; and

— Independence and objectivity considerations relating to other matters.

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 partners, Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. As a result we have underlying safeguards in place to maintain independence through:

— Instilling professional values

— Communications

— Internal accountability

— Risk management

— Independent reviews.

We are satisfied that our general procedures support our independence and objectivity.

Declaration of independence (cont.)

Independence and objectivity considerations relating to the provision of non-audit services

Summary of fees

We have considered the fees charged by us to the authority and its controlled entities for professional services provided by us during the reporting period. We have detailed the fees charged by us to the authority and its controlled entities for significant professional services provided by us during the reporting period in Appendix 7, as well as the amounts of any future services which have been contracted or where a written proposal has been submitted. Total fees charged by us for the period ended 31 March 2018 can be analysed as follows:

	2017-18 £	2016-17 £
Audit of the Authority	63,450*	70,490
Total audit services	**63,450**	**70,490**
Mandatory assurance services	7,043**	11,898**
Total Non Audit Services	**7,043**	**11,898**

* Prior to fee variation to be agreed in relation to King's Walk – see Appendix 7.

** The 2016/17 fee comprised the scale fee of £7,043 and a £4,855 fee variation for additional work performed on Housing Benefit subsidy. The 2017/18 certification work has not yet been completed so the fee shown is the scale fee set by PSAA.

We are required by AGN 01 to limit the proportion of fees charged for non-audit services (excluding mandatory assurance services) to 70% of the total fee for all audit work carried out in respect of the Authority under the Code of Audit Practice for the year. The ratio of non-audit fees to audit fees for the year was 0.1:1. We do not consider that the total of non-audit fees creates a self-interest threat since the absolute level of fees is not significant to our firm as a whole.

Facts and matters related to the provision of non-audit services and the safeguards put in place that bear upon our independence and objectivity, are set out table on the following page.

Declaration of independence (cont.)

Analysis of Non-audit services for the year ended 31 March 2018

Description of scope of services	Principal threats to independence and Safeguards applied	Basis of fee	Value of services delivered in the year ended 31 March 2018 £	Value of services committed but not yet delivered £
Mandatory assurance services				
Grant Certification – Housing Benefit Subsidy Return	The nature of this mandatory assurance service is to provide independent assurance on each of the returns. As such we do not consider it to create any independence threats.	Fixed Fee	0	7,043

Non-audit services provided during the period do not exceed the relevant PSAA deminimis threshold individually or in aggregate and therefore have not required PSAA approval. In addition, we monitor our fees to ensure that we comply with the 70% non-audit fee cap set by the NAO.

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the Audit & Governance Committee.

Confirmation of audit independence

We confirm that as of the date of this report, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the Audit & Governance Committee of the authority and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

KPMG LLP

Appendix 7:

Audit fees

As communicated to you in our *External Audit Plan 2017-18*, our scale fee for the audit is £63,450 plus VAT, which is consistent with the prior year scale fee, which was subject to a fee variation in relation to additional work performed over specific VFM issues (Together Gloucester, Contract Monitoring and Performance Management).

An additional fee is to be proposed for the additional work performed over the King's Walk shopping centre transaction. We are currently in the process of determining the value of this fee. The fee will be subject to PSAA's final determination.

Our work on the certification of the Authority's Housing Benefit Subsidy return is planned for July to November 2018. The planned scale fee for this is £7,043 plus VAT (£7,043 in 2016/17). The 2016/17 fee was subject to £4,855 fee variation for additional work performed on Housing Benefit subsidy, £880 of which is yet to be approved by PSAA.

Component of the audit	2017-18 Planned Fee £	2016-17 Actual Fee £
Accounts opinion and value for money work		
PSAA Scale fee (Gloucester City Council)	63,450	63,450
Additional fee in relation to specific VFM issues	-	7,040
Additional fee in relation to Kings Walk shopping centre	tbc	-
Total audit services	**tbc**	**70,490**
Mandatory assurance services		
Housing Benefits Certification (work planned for July to November)	7,043	11,898
Additional fee in relation to qualifications and additional work requested by DWP	-	4,855
Total mandatory assurance services	**7,043**	**11,898**
Total non-audit services	**7,043**	**11,898**
Grand total fees for the Authority	**tbc**	**82,388**

All fees quoted are exclusive of VAT.

The key contacts in relation to our audit are:

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. We draw your attention to the Statement of Responsibilities of auditors and audited bodies, which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

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

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

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