



GOVERNMENT

# Report to those charged with governance (ISA 260) 2009/10

**Cheltenham Borough Council**

**29<sup>th</sup> September 2010**

AUDIT

# Contents

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Report Sections		Page
<b>Section One</b>	Executive Summary	2
<b>Section Two</b>	Financial statements	X
<b>Section Three</b>	Use of resources	X

  

Appendices		Page
<b>Appendix A</b>	Proposed opinion on the financial statements	X
<b>Appendix B</b>	Proposed value for money conclusion	X
<b>Appendix C</b>	Recommendations	X
<b>Appendix D</b>	Follow-up of prior year recommendations	X
<b>Appendix E</b>	Audit differences	X
<b>Appendix F</b>	Declaration of independence and objectivity	X
<b>Appendix G</b>	Draft management representation letter	X

This report is addressed to the Authority and has been prepared for the sole use of the Council. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document.

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

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Ian Pennington, who is the engagement director to the Authority (telephone +44 29 20468087, email ian.pennington@kpmg.co.uk) who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees (0161 236 4000, email trevor.rees@kpmg.co.uk) who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Investigation Officer, Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR or by email to [complaints@audit-commission.gov.uk](mailto:complaints@audit-commission.gov.uk). Their telephone number is 0844 798 3131, textphone (minicom) 020 7630 0421.

## Executive summary

### Scope of this report

This report summarises:

- the key issues identified during our audit of Cheltenham Borough Council's ('the Authority's') financial statements for the year ended 31 March 2010; and
- our assessment of the Authority's arrangements to secure value for money in its use of resources.

This report does not repeat matters we have previously communicated to you. In particular, we draw your attention to our *Interim Audit Report 2009/10*, presented to you on 23<sup>rd</sup> June 2010, which summarised our planning and interim audit work.

### Financial Statements

The table below summarises the key findings from our work in relation to the financial statements audit. Section two of this document provides further details.

<b>Proposed opinion</b>	We anticipate issuing an unqualified audit opinion by 30 September 2010. We will also report that the wording of your Annual Governance Statement accords with our understanding.
<b>Accounts production and audit process</b>	<p>The quality of the accounts and the supporting working papers provided to us was again excellent. Officers dealt efficiently with audit queries and the audit process has been completed to the planned timescales.</p> <p>The Authority has implemented the recommendations in our ISA 260 Report 2008/09 relating to the financial statements.</p>

<b>Critical accounting matters</b>	We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed the issues raised appropriately.
<b>Audit differences</b>	<p>Our audit has identified only one potential audit adjustment of £133,700. As a result of its small size relative to the accounts it has not been adjusted and is reported as an unadjusted audit difference.</p> <p>This result demonstrates the high level of care and resource that the finance team put into preparing the financial statements and the audit.</p> <p>No audit adjustments were posted to the financial statements therefore there has been no change in the numbers reported to the Audit Committee on 23 June 2010.</p> <p>We have included the detail of the unadjusted difference at Appendix E.</p>
<b>Completion</b>	<p>At the date of this report our audit of the financial statements is complete.</p> <p>Before we can issue our opinion we require a signed management representation letter.</p> <p>We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.</p>

We have raised a number of recommendations in relation to the matters highlighted above, which are summarised in Appendix C.

## Executive summary

### Use of Resources

The table below summarises the key findings from our assessment of the Authority's arrangements to secure value for money in its use of resources.

Our findings are detailed in section three of this report.

<b>Proposed opinion</b>	We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.
<b>Use of resources assessment</b>	<p>Following the change in government, the use of resources assessment at local authorities ceased with immediate effect in May 2010.</p> <p>The Authority will therefore not receive scores in respect of the 2010 assessment.</p>

### Exercise of other powers

We have a duty under section 8 of the Audit Commission Act 1998 to consider whether, in the public interest, to report on any matter that comes to our attention in order for it to be brought to the attention of the public. In addition we have a range of other powers under the 1988 Act.

On 2 March 2010 we issued a report in the public interest under section 8 of the Audit Commission Act 1998 on the subject of weaknesses in the Authority's corporate governance arrangements, which included a number of recommendations for the Authority to action.

We have not needed to exercise auditor powers during the 2009/10 audit.

### Certificate

We are required to certify that we have completed the audit in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice. If there are any circumstances under which we cannot issue a certificate, then we are required to report them to you and to issue a draft opinion on the financial statements.

At present there are no issues that would cause us to delay the issue of our certificate of completion of the audit.

### Acknowledgements

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

# Introduction

**We have completed our work on the 2009/10 financial statements.**

**We anticipate issuing an unqualified audit opinion by 30 September 2010.**

## The Authority’s and our responsibilities

Cheltenham Borough Council is responsible for having effective systems of internal control to ensure the regularity and lawfulness of transactions, to maintain proper accounting records and to prepare financial statements that give a true and fair view of its financial position and its expenditure and income. It is also responsible for preparing and publishing an Annual Statement of Governance with its financial statements.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

The Audit Commission’s Code of Audit Practice requires us to summarise the work we have carried out to discharge our statutory audit responsibilities together with any governance issues identified and we report to those charged with governance (in this case the Audit Committee) at the time they are considering the financial statements.

We are also required to comply with International Standard on Auditing (ISA) 260 which sets out our responsibilities for communicating with those charged with governance.

This report meets both these requirements.

## Introduction

Our audit of the financial statements can be split into four phases:



We previously reported on our work on the first two stages in our *Interim Audit Report 2009/10* issued on 23 June 2010.

This report focuses on the final two stages: substantive procedures and completion. It also includes any additional findings in respect of our control evaluation that have been identified since we issued our *Interim Audit Report 2009/10*.

## Substantive Procedures

Our final accounts visit on site took place between August and September. During these 4 weeks, we carried out the following work:

- |                               |   |
|-------------------------------|---|
| <b>Substantive Procedures</b> | <ul style="list-style-type: none"> <li>● Planning and performing substantive audit procedures</li> <li>● Concluding on critical accounting matters</li> <li>● Identifying audit adjustments</li> <li>● Reviewing the Annual Governance Statement</li> </ul> |
|-------------------------------|---|

We have completed our audit of the Authority’s 2009/10 financial statements.

## Completion

We are now in the final phase of the audit. Some aspects are discharged through this report:

- |                   |   |
|-------------------|---|
| <b>Completion</b> | <ul style="list-style-type: none"> <li>● Declaring our independence and objectivity</li> <li>● Obtaining management representations</li> <li>● Reporting matters of governance interest</li> <li>● Forming our audit opinion</li> </ul> |
|-------------------|---|

We anticipate issuing an unqualified audit opinion by 30 September 2010.

## Accounts production and audit process

**We have noted that the accounts and the supporting working papers were well prepared and of an excellent standard.**

**Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales.**

**The Authority has implemented the recommendation in our ISA 260 Report 2008/09 relating to the financial statements.**

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

### Accounts production and audit process

ISA 260 requires us to communicate to you our views about the qualitative aspects of the Authority’s accounting practices and financial reporting.

We also assessed the Authority’s process for preparing the accounts and its support for an efficient audit.

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority has a structured financial reporting process which provides reasonable assurance that the accounts are prepared to a strong standard. We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 1 July 2010. There were no amendments following the Audit Committee meeting on 23 June 2010 when the draft financial statements were discussed. A number of presentational differences were identified, all of which have been corrected in the accounts.
Quality of supporting working papers	Our Accounts Audit Protocol, which we issued on 30 <sup>th</sup> June 2010, set out our working paper requirements for the audit. The quality of working papers provided was excellent. The working papers requested by KPMG as part of the accounts audit protocol were all provided by finance on time. The working papers were clearly referenced and a good trail existed.

Element	Commentary
Response to audit queries	Staff were available when required throughout the audit. All additional audit queries were resolved in a reasonable time.

### Prior year recommendations

In our *Interim Audit Report 2009/10* we commented on the Authority’s progress in addressing the recommendations in our *ISA 260 Report 2008/09*.

The Authority has implemented all of the recommendations in our *ISA 260 Report 2008/09* relating to the financial statements.

Appendix D provides further details.

### Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that

- it complies with *Delivering Good Governance in Local Government: A Framework* published by CIPFA/SOLACE in June 2007; and
- it is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

## Critical accounting matters

**We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.**

### Work completed

- In our *Financial Statements Audit Plan 2009/10*, presented to you on 24 March 2010, we identified the key risks affecting the Authority's 2009/10 financial statements.
- In our *Interim Audit Report 2009/10* we commented on the Authority's progress in addressing these key risks. We highlighted that our work completed to date had not raised any areas of concern.

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

### Key findings

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

Key audit risk	Issue	Findings
 <p><b>Valuation of Investments</b></p>	<ul style="list-style-type: none"> <li>• We will review the Council's valuation to ensure that it is consistent with LAAP 82 'Guidance on the Impairment of Icelandic Banks' and any subsequent updates.</li> <li>• We will assess valuation assumptions for appropriateness.</li> <li>• We will review that the Council has appropriately applied the Capitalisation Directive per the regulations released by the Department for Communities and Local Government in 2009.</li> </ul>	<ul style="list-style-type: none"> <li>• Additional Impairment losses of £335k have been recognised in the income and expenditure account during 2009/10 (prior year £5,035k).</li> <li>• The Council was successful in its application to the government for a capitalisation direction of £4.430m during the year.</li> <li>• We note that the valuation of Icelandic Investments has been undertaken in line with LAAP 82 'Guidance on the impairment of investment banks' and the Capitalisation Direction has been applied correctly.</li> </ul>
 <p><b>Local Taxes/ Rent Arrears</b></p>	<ul style="list-style-type: none"> <li>• We will review the Council's processes for collecting and recovering outstanding balances in relation to council tax, national non-domestic rates (NNDR) and rent arrears.</li> <li>• We will critically review the level of bad debt write offs and bad debt provisioning at the year end. We will perform a trend analysis of the level of balances over the last financial year and compare the Council's performance to similar organisations.</li> </ul>	<ul style="list-style-type: none"> <li>• We reviewed the levels of tax and rent arrears at year-end. Management has reviewed the year end bad debt provision levels and there does not appear to be any significant issues with recoverability of debt in the current economic climate.</li> <li>• There has been a significant increase in bad debt expense during the year which totalled £615k (2008/09 £ 377k) and we understand that this is mainly as a result of the state of the economy and particularly Woolworths going into Administration during the year.</li> </ul>

## Critical accounting matters (continued)

Key audit risk	Issue	Findings
 <p style="text-align: center;"><b>Valuation of Fixed Assets</b></p>	<ul style="list-style-type: none"> <li>• We will review the Council's accounting policies for fixed assets to ensure that they are appropriately valued.</li> <li>• We will assess valuation assumptions for appropriateness.</li> <li>• We will review the Council's processes for identifying fixed asset and investments which may require impairment and consider whether these impairments have been accounted for correctly within the financial statements.</li> </ul>	<ul style="list-style-type: none"> <li>• Assets included in the balance sheet in line with SORP 2009 and are revalued when there have been material change in the value, but at a minimum of every five years.</li> <li>• A 5 year formal valuation of Council held land &amp; buildings and investment properties took place on the 1<sup>st</sup> April 2009 and was completed by professional external valuer firm GVA Grimley.</li> <li>• Council held land and buildings were revalued downwards by £10.1m. The largest decreases affected the Pump Room (£4.4m), Town Hall (£3.3m), Prince of Wales Stadium (£1.2m) and mainly reflect the change in the property market over the last five years.</li> <li>• However the valuation did include a significant increase of £3.19m, related to the Everyman and Playhouse theatres. The increase has arisen from a change in the valuation base: the last valuation was based on rental stream, and as this is very low the theatres were valued at £nil. However, during this valuation it was decided that the properties should be valued at depreciated replacement value to more accurately reflect the value of the properties to the council taxpayers of Cheltenham.</li> <li>• KPMG considered that the valuation as at 1 April 2009 was complete and appropriate and that management has provided assurances that although there has been some fluctuation between 1 April 2009 and 31 March 2010 these fluctuations are not significant and no further adjustment to the valuation is required.</li> </ul>
 <p style="text-align: center;"><b>Implementation of IFRS</b></p>	<ul style="list-style-type: none"> <li>• All public sector bodies are required to present their Statement of Accounts in accordance with IFRS accounting regulations for 2010-11.</li> <li>• We will review the Council's progress on implementing IFRS against its detailed convergence plan. In particular we will consider the steps taken to restate opening balances.</li> <li>• We will hold regular discussions with officers to identify areas of pressure where difficulties are being experienced. We will offer support and guidance during the convergence process.</li> </ul>	<ul style="list-style-type: none"> <li>• The Council appears to be making good progress implementing IFRS's against its detailed convergence plan.</li> <li>• KPMG reviewed Internal Audit's observations regarding the Council's current preparation and implementation of IFRS regulations in September 2010. No areas of major risk were raised, which is in line with KPMG's understanding.</li> <li>• The Council plan to complete the IFRS restatement of the 2009/10 (and prior year figures) after the completion of the 2009/10 audit.</li> <li>• KPMG will review the conversion once completed, in the meantime we will continue to hold regular discussions with officers regarding progress.</li> </ul>

## Critical accounting matters (continued)

Key audit risk	Issue	Findings
 <p style="text-align: center;"><b>Pension scheme</b></p>	<ul style="list-style-type: none"> <li>The Authority has a defined benefit pension scheme which is a significant balance in the Balance Sheet at 31 March 2010 amounting to £70.4m (2009: £37.1m).</li> </ul>	<ul style="list-style-type: none"> <li>The Authority has accounted for the its share of the pension liabilities of the Local Government Pension Scheme (LGPS), Gloucestershire County Council, in accordance with FRS 17.</li> <li>The pension scheme liabilities have increased significantly from the previous year as a result of the decrease in the discount rate applied in the actuarial calculation of the present value of defined benefit obligation (FRS17 liabilities). The increase in liabilities did not result to an increase in pension costs therefore does not impact the Income and Expenditure account. The increase however, was recognised in the Statement of Recognised Gains and Losses.</li> <li>Since the year end the Chancellor of the Exchequer announced in his Emergency Budget on 22 June 2010 that the consumer prices index (CPI) rather than the retail prices index (RPI) will be the basis for the future public sector pension increases. In accordance with paragraph 21 of Financial Reporting Standard 21 (Events after the balance sheet date), this change is deemed to be a non-adjusting event. It is estimated that this change will reduce the value of pension liability by £8.4m. A disclosure has been made in the accounts to state this fact.</li> </ul>

## Audit differences

**We have identified no issues in the course of the audit that are considered to be material and required adjustment.**

### Work completed

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.

### Key findings

We did not identify any material misstatements. We identified one issue that has not been adjusted by management as it does not have a material effect on the financial statements.

We have provided details of the unadjusted audit difference in Appendix E.

We identified a number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting the United Kingdom 2009: A Statement of Recommended Practice* ('SORP'). We understand that the Authority will be addressing these where significant.

The tables below shows the Authority's income and expenditure account for the year and balance sheet as at 31 March 2010 as the same both pre and post audit.

Income & expenditure 2009/10	Pre and post-audit £m
Net cost of services	44.8
Net other operating expenditure	3.8
<b>Deficit for the year</b>	<b>48.6</b>
Net additional credits	
Demand on the Collection Fund	(7.8)
General Government Grants	(1.7)
Non-Domestic Rates Redistribution	(7.1)
Net other net debits/credits (including reversal of Impairment on Icelandic Banks and the Capitalisation Direction, depreciation and impairment charges , pension charges and transfers from HRA and earmarked reserves)	32  (31.7)
<b>Increase in General Fund</b>	<b>0.3</b>

Balance Sheet as at 31 March 2010	Pre and post-audit £m
Fixed assets	305.3
Other long term assets	31.7
Current assets	8.6
Current liabilities	(25.3)
Long term liabilities	(113.6)
<b>Net worth</b>	<b>206.7</b>
General Fund	(2.4)
Other reserves	(204.3)
<b>Total reserves</b>	<b>(206.7)</b>

## Completion

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

**Before we can issue our opinion we require a signed management representation letter, and have provided a draft version at Appendix G.**

**Once we have finalised our opinions and conclusions we will 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 Cheltenham Borough Council for the year ending 31 March 2010, we confirm that there were no relationships between KPMG LLP and Cheltenham Borough Council Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix F 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 included a copy of a representation letter as Appendix G. We have provided a draft to Mark Sheldon (the Section 151 Officer). We require a signed copy of your management representations before we issue our audit opinion.

### **Other matters**

ISA 260 requires us to communicate "audit matters of governance interest that arise from the audit of the financial statements" to you which includes:

- material weaknesses in internal control identified during the audit;
- matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. issues relating to fraud, compliance with laws and regulations, subsequent events etc); and
- other audit matters of governance interest.

There are no others matters which we wish to draw to your attention.

### **Opinion**

We anticipate issuing an unqualified audit opinion by 30 September 2010.

Our proposed opinion on the financial statements is presented in Appendix A.

## Introduction

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

### The Authority's and our responsibilities

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources and regularly reviewing their adequacy and effectiveness.

We are required to conclude whether the Authority has adequate arrangements in place to ensure effective use of its resources. We refer to this as the 'value for money (VFM) conclusion'.

### Introduction

Our assessment previously drew mainly on the findings from the use of resources assessment (UoR) framework, as the specified criteria for the VFM conclusion were the same as the UoR Key Lines of Enquiry (KLoE).

In May 2010 the new government announced that the Comprehensive Area Assessment (CAA) would be abolished. The Audit Commission subsequently confirmed that work related to CAA should cease with immediate effect. This includes work for UoR assessments at local authorities.

However, there is no change to the requirement in the statutory Code of Audit Practice for auditors to issue a VFM conclusion.

At the time of the announcement, the vast majority of UoR work for 2010 had already been completed and this therefore informed our 2009/10 VFM conclusion. We provided some commentary on our findings within our Interim Audit Report 2009/10.

We also identified a number of specific risks impacting on our 2009/10 value for money conclusion and undertook targeted work on these areas.

### Conclusion

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

Our proposed conclusion is set out in Appendix B.

VFM criterion	Met
<b>Managing finances</b>	
Financial planning	✓
Understanding costs and achieving efficiencies	✓
Financial reporting	✓
<b>Governing the business</b>	
Commissioning and procurement	✓
Data quality and use of information	✓
Governance	✓
Risk management and internal control	✓
<b>Managing resources</b>	
Use of natural resources	✓
Strategic asset management	*
Workforce planning	*

\* The audit commission does not require 'strategic assets management' and 'workforce planning' to be concluded on in 2009-10. Workforce planning was assessed in 2008/09 and we concluded it met the VFM criteria.

The following pages include further details on the use of resources assessment and specific risk-based work.

## Use of resources assessment

**The Audit Commission announced that its use of resources assessment at local authorities ceased with immediate effect in May 2010.**

**The Authority will therefore not receive scores in respect of the 2010 assessment.**

### Work completed

- We completed work on the 2010 use of resources assessment between March and April 2010.
- Our work involved review of the Authority’s self-assessment, discussions with key officers for all areas and review of relevant internal and external documentation.
- We also completed additional work during May to June where we considered this to be still relevant to our VFM conclusion.

### Key findings

- Even though the 2010 UoR assessment was substantially completed, we have been advised by the Audit Commission not to share indicative scores with audited bodies.

- We have therefore only included general messages in this report about the Authority’s performance in each area. In particular, we have highlighted the key issues which we consider should be brought to the attention of those charged with governance. More detailed feedback will be provided to Bryan Parsons.
- Below we set out our findings in respect of each area.

	Headlines	Issues arising
<b>Managing finances</b>	<ul style="list-style-type: none"> <li>• Our 2009 UoR audit indicated that the Council had strong arrangements for managing its finances, with a level 3 score awarded last year.</li> <li>• We reviewed evidence regarding the Council’s ability to manage its finances effectively, its understanding of costs and performance and the Council’s ability to report financial information in a reliable and timely manner. This confirmed that the Council has continued to demonstrate these strong arrangements and we have identified no issues.</li> <li>• We noted the following good practices regarding managing finances:                             <ul style="list-style-type: none"> <li>– the Council has been fully involved in driving forward partnership initiatives to identify and deliver cost savings, such as the shared legal practice and the GO project;</li> <li>– the ‘Bridging the Gap’ programme has identified several cost saving programmes. The project encouraged ideas from all staff members as well as a benchmarking exercise of council fees against market data; and</li> <li>– the CIPFA benchmarking report notes that Cheltenham’s costs are below trend and have also been declining since 2005. This provides evidence of a good understanding of costs.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• There are no significant issues to raise in 2009/10 which have impacted on the theme score.</li> </ul>

## Use of resources assessment (continued)

## Governing the business

Headlines	Issues arising
<ul style="list-style-type: none"> <li>● Our 2009 UoR audit indicated that the Council has adequate governance arrangements overall, with a level 2 score awarded last year.</li> <li>● We reviewed evidence regarding the Council's ability to commission and procure quality services, that decision making is supported by relevant and reliable information, that the Council promotes and demonstrates the principles of good governance, that the Council manages its risks and maintains a sound system of control.</li> <li>● We noted a number of good practices, including: <ul style="list-style-type: none"> <li>– the Council has a clear vision which supports the Business Plan and Medium Term Financial Strategy; and</li> <li>– in April 2009 the Council held a conference with the intended aim of engaging the local community regarding the future roll out and aims of the community.</li> </ul> </li> <li>● We qualified our VFM conclusion in 2008/09 accounts issued on 14 June 2010 on the grounds that the Council did not have adequate arrangements in place for producing relevant and reliable data and information to support decision making and manage performance; promoting and demonstrating the principles and values of good governance; and managing its risks and maintaining a sound system on internal controls as a result of our Public Interest Report which was published in March 2010.</li> </ul>	<ul style="list-style-type: none"> <li>● We reported last year that not all contracts had been let in accordance with the Council's Financial Regulations, and it could not be confirmed that all contracts had been monitored effectively. During 2009/10 additional resource has been taken on in the procurement department to help ensure that the procurement controls are more fully embedded and working effectively.</li> <li>● Individual departments are responsible for maintaining their own risk registers. It was noted that one departmental risk register had not been updated in a timely manner in the year.</li> <li>● Our Public Interest Report in March 2010 noted a number of issues relating to the effectiveness and application of established governance arrangements. The Council's governance processes are generally effective and adhered to, but the PIR highlighted the breakdown, in 2008/09 and earlier periods, of some established controls around the particular circumstances concerned, which had not been applied fully in the usual way. These centred on: <ul style="list-style-type: none"> <li>– risk management; and</li> <li>– reporting information to Members for decision making.</li> </ul> </li> <li>● The PIR does not undermine the view that the Council has sound governance arrangements, but it does highlight the need to ensure that they are applied fully and consistently in all circumstances. The Council has a detailed action plan in place to address the issues raised by the PIR.</li> <li>● As the action plan is in the process of being implemented and it is being monitored by the Audit Committee, and the governance processes have otherwise been effective and we have not observed a similar issue in 2009/10, we have concluded that we do not need to qualify our VFM conclusion again in 2009/10.</li> </ul>

## Use of resources assessment (continued)

**Managing resources**

Headlines	Issues arising
<ul style="list-style-type: none"> <li>● Our 2009 UoR audit indicated that the Council has strong arrangements for planning, organising and developing its workforce effectively to support the achievement of its strategic priorities, with a level 3 score awarded last year.</li> <li>● This year, we reviewed evidence regarding the Council’s arrangements for understanding and quantifying the use of natural resources and managing performance to reduce impact on the environment and managing environmental risks.</li> <li>● We noted the following good practices in the period:                         <ul style="list-style-type: none"> <li>– the Council has challenging targets and monitoring programmes in place for energy and CO<sub>2</sub> emissions, water usage and paper recycling, and is performing well against these targets; and</li> <li>– the Procurement team asks all potential tenders to note their environmental credentials in less than 300 words, and this is scored 0 to 5 and used as part of the procurement decision making process.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>● Recycling is monitored by the council on a building by building basis; currently only figures for paper are monitored formally. We would encourage monitoring to be expanded to all materials recycled so that the Council can set targets and measure performance effectively .</li> </ul>

## Appendix A: Proposed Opinion on the Financial Statements

**Our opinion states whether the accounting statements and related notes give a true and fair view of the financial position of the Authority and its income and expenditure for the year.**

**We define what mean by 'accounting statements'.**

### Independent auditors' report to the Members of Cheltenham Borough Council

#### Opinion on the accounting statements

We have audited the accounting statements, and related notes of Cheltenham Borough Council for the year ended 31 March 2010 under the Audit Commission Act 1998. The accounting statements comprise the Authority and Group Income and Expenditure Account, the Authority and Group Statement of Movement on the General Fund Balance, the Authority and Group Balance Sheet, the Authority and Group Statement of Total Recognised Gains and Losses, the Authority and Group Cash Flow Statement, the Housing Revenue Account Income and Expenditure Account, the Statement of Movement on the Housing Revenue Account and the Collection Fund. The accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to Cheltenham Borough Council, as a body, in accordance with Part II of the Audit Commission Act 1998. Our audit work has been undertaken so that we might state to Cheltenham Borough Council, as a body, those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than Cheltenham Borough Council, as a body, for our audit work, for this report, or for the opinions we have formed.

#### Respective responsibilities of the Chief Finance Officer (Section 151 Officer) and auditors

The Chief Finance Officer (Section 151 Officer) responsibilities for preparing the financial statements in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009 are set out in the Statement of Responsibilities for the Statement of Accounts.

Our responsibility is to audit the accounting statements and related notes in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the accounting statements and related notes give a true and fair view, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009 of:

- the financial position of the Authority and its income and expenditure for the year;
- the financial position of the Group and its income and expenditure for the year;

We review whether the governance statement reflects compliance with 'Delivering Good Governance in Local Government: A Framework' published by CIPFA/SOLACE in June 2007. We report if it does not comply with proper practices specified by CIPFA/SOLACE or if the statement is misleading or inconsistent with other information we are aware of from our audit of the financial statements. We are not required to consider, nor have we considered, whether the governance statement covers all risks and controls. Neither are we required to form an opinion on the effectiveness of the Authority's corporate governance procedures or its risk and control procedures.

## Appendix A: Proposed Opinion on the Financial Statements (continued)

**Our proposed opinion is unqualified.**

**There are no expected modifications to the auditors' report.**

We read other information published with the accounting statements and related notes and consider whether it is consistent with the audited accounting statements and related notes. This other information comprises the Explanatory Foreword and the content of the Annual Governance Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounting statements and related notes. Our responsibilities do not extend to any other information.

### **Basis of audit opinion**

We conducted our audit in accordance with the Audit Commission Act 1998, the Code of Audit Practice issued by the Audit Commission and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounting statements and related notes. It also includes an assessment of the significant estimates and judgments made by the Authority in the preparation of the accounting statements and related notes, and of whether the accounting policies are appropriate to the Authority's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounting statements and related notes are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounting statements and related notes.

### **Opinion**

In our opinion the accounting statements and related notes give a true and fair view, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009, of the financial position of the Authority and its Group as at 31 March 2010 and its income and expenditure for the year then ended

## Appendix B: Proposed use of resources conclusion

**Our proposed use of resources conclusion is unqualified.**

### **Conclusion on arrangements for securing economy, efficiency and effectiveness in the use of resources**

#### **Authority's Responsibilities**

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance and regularly to review the adequacy and effectiveness of these arrangements.

#### **Auditors' Responsibilities**

We are required by the Audit Commission Act 1998 to be satisfied that proper arrangements have been made by the Authority for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires us to report to you our conclusion in relation to proper arrangements, having regard to relevant criteria specified by the Audit Commission for principal local authorities. We report if significant matters have come to our attention which prevent us from concluding that the Authority has made such proper arrangements. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

#### **Conclusion**

We have undertaken our audit in accordance with the Code of Audit Practice. Having regard to the criteria for principal local authorities specified by the Audit Commission and published in May 2008 and updated in February 2009, we are satisfied that, in all significant respects, Cheltenham Borough Council made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2010.

#### **Ian Pennington**

#### **Senior Statutory Auditor**

#### **for and on behalf of KPMG LLP, Statutory Auditor**

*Chartered Accountants*

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# Appendix A – Key issues and recommendations

This Appendix sets out the issues and recommendations identified by KPMG as part of our review of procedures and controls at Cheltenham Borough Council which have been identified during the final audit visits.

We have given each recommendation a risk rating (as explained below) and agreed what action management will need to take. We will follow up these recommendations next year.

Priority rating for recommendation		
<p><b>Priority one:</b> 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.</p> <p style="text-align: right;"><b>1</b></p>	<p><b>Priority two:</b> 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.</p> <p style="text-align: right;"><b>2</b></p>	<p><b>Priority three:</b> 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.</p> <p style="text-align: right;"><b>3</b></p>

No.	Risk	Issue and Recommendation	Management Response / Responsible Officer / Due Date
1	<b>2</b>	<p><b>Issue – Lack of evidence of review of bank reconciliation</b></p> <p>The monthly bank reconciliation review is currently not evidenced by a signature and date and therefore no audit trail exists of the management review which is an important part of the control processes.</p> <p><b>Recommendation</b></p> <p>The bank reconciliations are signed and dated as evidence of the monthly review process.</p>	<p>Although regularly reviewed, the authority recognises that no formal signatory was evident for a number of reconciliations and has put in practice the requirement to ensure all future bank reconciliations are signed and dated.</p>
2	<b>2</b>	<p><b>Issue – Lack of high level monthly payroll review</b></p> <p>We noted that currently there is no high level review of the payroll before authorisation and payment each month. A central high level review could check any significant month on month variances before payment of the payroll. There is limited payroll exception reporting with the current payroll system and this high level overview would provided added assurance until a new payroll system is introduced.</p> <p><b>Recommendation</b></p> <p>A monthly high level review examining any significant monthly variances would give additional assurances of the completeness and accuracy of the payroll payment which is one of the most significant costs of the council.</p>	<p>As agreed following the recommendations of the recent internal audit review, with effect from September 2010 the payroll BACS authorisation form and supporting papers will be reviewed and signed off by a manager independent of the payroll input team.</p>

## Appendix A – Key issues and recommendations

No.	Risk	Issue and Recommendation	Management Response / Responsible Officer / Due Date
3	2	<p><b>Issue – Lack of evidence of review of income reconciliations</b>                      We noted that currently there is a lack of evidence of the review of the income reconciliation of the debtors system to the cash receipting system using the daily ASH reports, as the reconciliation is not signed or dated.</p> <p><b>Recommendation</b>                      The reconciliations are signed and dated as evidence of review which leaves a clear audit trail of the completion of the control.</p>	<p>The Senior Revenues Control Officer will in future initial and date the file as evidence of a weekly review. In addition the Revenues Manager will also initial and date the file when reviewing the reconciliation on a monthly basis.</p>
4	2	<p><b>Issue – lack of documentation of the NNDR reconciliation</b>                      We noted that there is a lack of evidence of the review of the reconciliation between the NNDR and the IBS reports.</p> <p><b>Recommendation</b>                      The reconciliations are signed and dated to evidence that the control is operating effectively.</p>	<p>A spreadsheet is completed documenting the reconciliation. As with issue 3 above, the file will be initialled and dated by the Senior Revenues Control Officer on a weekly basis and by the Revenues Manager monthly.</p>

# Appendix B – Follow-up of prior year recommendations

The Authority has implemented all of the recommendations from our 2008/09 audit.

We have not yet followed up on the recommendations issued in our interim report as this report was issued in June 2010. We will follow up these points next year.

This Appendix summarises the progress made to implement the recommendations identified in 2008/09 audit and the interim report issued in June 2010. We have not considered progress against the Public Interest Report and also the interim audit report as these reports were issued in March 2010 and June 2010 respectively.

Number of recommendations that were:			
Included in original report	Included in original report	Implemented in year or superseded	Remain outstanding
2009/10 Interim Report	9	-	9
2008/09 ISA 260 Report	1	1	0

No.	Risk	Issue and Recommendation	Status as at September 2010
1	2	We reported last year that not all contracts had been let in accordance with the Council’s Financial Regulations, and it could not be confirmed that all contracts had been monitored effectively.	<p><b>In progress</b></p> <p>During 2009/10 additional resource has been taken on in the procurement department to help ensure that the procurement controls are more fully embedded and working effectively.</p>

## Appendix E: Audit differences

**No significant audit adjustments were identified during the course of the audit.**

**Only one immaterial adjustment was identified.**

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which in the Authority's case is the Audit Committee). We are also required to report all material misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities.

### Corrected audit differences

We have not identified any significant audit differences during the course of our audit which require adjustment in the financial statements.

### Uncorrected audit differences

The following table sets out the uncorrected audit difference identified by our audit of the financial statements for the year ended 31 March 2010.

Income and expenditure	Statement of Movement on GF Balance	Impact			Basis of audit difference
		Assets	Liabilities	Reserves	
Dr Impairment charge in I&E Account £133.7k		Cr HRA fixed assets £133.7k			Adjustment to the correct the calculation of the impairment cost on the council dwellings that have been demolished during the year.
<b>133.7k</b>	-	<b>(133.7k)</b>	-	-	<b>Total impact of audit differences</b>

## Appendix F: Declaration of independence and objectivity

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

### Requirements

Auditors appointed by the Audit Commission must comply with the *Code of Audit Practice* (the Code) which states that:

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

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Audit Commission’s *Standing guidance for local government auditors* (‘Audit Commission Guidance’) and the requirements of APB Ethical Standard 1 *Integrity, Objectivity and Independence* (‘Ethical Standards’).

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

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

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 Audit Engagement Lead and the audit team.

## Appendix F: Declaration of independence and objectivity (continued)

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

### **General procedures to safeguard independence and objectivity**

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

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

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

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

### **Auditor Declaration**

In relation to the audit of the financial statements of Cheltenham Borough Council for the financial year ending 31 March 2010, we confirm that there were no relationships between KPMG LLP and the Cheltenham Borough Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

## Appendix G: Draft management representation letter

**We ask you 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.**

**The wording for these representations is standard and prescribed by auditing standards.**

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

Dear KPMG LLP,

We understand that auditing standards require you to obtain representations from management on certain matters material to your opinion. Accordingly we confirm to the best of our knowledge and belief, having made appropriate enquiries of other members of the Authority, the following representations given to you in connection with your audit of the financial statements for Cheltenham Borough Council for the year ended 31 March 2010.

All the accounting records have been made available to you for the purpose of your audit and the full effect of all the transactions undertaken by Cheltenham Borough Council has been properly reflected and recorded in the accounting records in accordance with agreements, including side agreements, amendments and oral agreements. All other records and related information, including minutes of all management and Committee meetings, have been made available to you.

We confirm that we have disclosed all material related party transactions relevant to the Authority and that we are not aware of any other such matters required to be disclosed in the financial statements, whether under FRS 8 or other requirements.

We confirm that we are not aware of any actual or potential non-compliance with laws and regulations that would have had a material effect on the ability of the Authority to conduct its business and therefore on the results and financial position to be disclosed in the financial statements for the year ended 31 March 2010.

We acknowledge that we are responsible for the fair presentation of the financial statements in accordance with the Local Government Statement of Recommended Practice ("SORP") and wider UK accounting standards. We have considered and approved the financial statements.

We confirm that we:

- understand that the term "fraud" includes misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Misstatements resulting from fraudulent financial reporting involve intentional misstatements or omissions of amount or disclosures in financial statements to deceive financial statement users. Misstatements resulting from misappropriation of assets involve the theft of an entity's assets, often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorisation;
- are responsible for the design and implementation of internal control to prevent and detect fraud and error;
- have disclosed to you our knowledge of fraud or suspected fraud affecting the Authority involving:
  - management;
  - employees who have significant roles in internal control; or
  - others where the fraud could have a material effect on the financial statements.
- have disclosed to you our knowledge of any allegations of fraud, or suspected fraud, affecting the Authority's financial statements communicated by employees, former employees, analysts, regulators or others; and
- have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

## Appendix G: Draft management representation letter (continued)

We confirm that the presentation and disclosure of the fair value measurements of material assets, liabilities and components of equity are in accordance with applicable reporting standards. The amounts disclosed represent our best estimate of fair value of assets and liabilities required to be disclosed by these standards. The measurement methods and significant assumptions used in determining fair value have been applied on a consistent basis, are reasonable and they appropriately reflect our intent and ability to carry out specific courses of action on behalf of the Authority where relevant to the fair value measurements or disclosures.

We confirm that there are no other contingent liabilities, other than those that have been properly recorded and disclosed in the financial statements. In particular:

- there is no significant pending or threatened litigation, other than that already disclosed in the financial statements; and
- there are no material commitments or contractual issues, other than those already disclosed in the financial statements.

Finally, no additional significant post balance sheet events have occurred that would require additional adjustment or disclosure in the financial statements, over and above those events already disclosed.

This letter was tabled at the meeting of the Audit Committee on 29 September 2010.

Yours faithfully

Mark Sheldon

Chief Finance Officer (Section 151 Officer)

On behalf of Cheltenham Borough Council