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VFM audit approach 2010/11

Cheltenham Borough Council

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This report is addressed to Cheltenham Borough Council (the Council) and has been prepared for your use only. We accept no responsibility towards any member of staff acting on their own, or to any 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 Council. We draw your attention to this document.

External auditors do not act as a substitute for the Council'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 lead to the Council (telephone 029 2046 8087 or 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 246 4000 or trevor.rees@kpmg.co.uk), who is the national contact partner for all of KPMG's work with the Audit Commission.

After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR or by email to complaints@audit-commission.gov.uk. Their telephone number is 0844 798 3131, textphone (minicom) 020 7630 0421.

Our audit is divided into:

- Use of resources; and
- Financial statements.

This document describes how the new VFM audit approach will operate to fulfil our use of resources responsibilities.

Our responsibilities

Our statutory responsibilities and powers are set out in the Audit Commission Act 1998 (the Act) and the Commission's *Code of Audit Practice* (the Code). The Code summarises our responsibilities into two objectives, requiring us to review and report on your:

- *use of resources*: concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the value for money (VFM) conclusion); and
- *financial statements (including the Annual Governance Statement)*: providing an opinion on your accounts.

We have already provided information on our detailed financial statements audit approach in our separate Financial Statements Audit Plan 2010/11. This document focuses on our use of resources (UoR) audit and in particular highlights the key changes to the new approach introduced this year by the Audit Commission compared to the previous UoR auditor's scored judgements regime. It does not repeat any other aspects of the Financial Statements Audit Plan (e.g. independence declarations, fee disclosures etc).

Summary of new VFM audit approach

Although the purpose of the VFM audit remains the same – to form a view on the adequacy of the Council's arrangements for securing economy, efficiency and effectiveness in the use of its resources – and there are many similarities in the new approach, there are also some notable differences. These are summarised in the table below.

Previous UoR audit regime	New VFM audit regime
<ul style="list-style-type: none"> ■ Three themes (managing finances, governing the business and managing resources) covering ten key lines of enquiry (KLOE). 	<ul style="list-style-type: none"> ■ Reduced to two themes (financial resilience and securing VFM) with five sub-themes. There remains considerable overlap in coverage, but some aspects (e.g. natural resources) are not now considered.
<ul style="list-style-type: none"> ■ Scored judgements overall, for each of the three themes and each KLOE. These scores informed the VFM conclusion. 	<ul style="list-style-type: none"> ■ No scored judgements. The VFM conclusion is the only output, which remains a 'pass / fail' style assessment.
<ul style="list-style-type: none"> ■ Detailed guidance available for each KLOE describing the standards and performance required to achieve levels 2 and 3. 	<ul style="list-style-type: none"> ■ More summarised characteristics replace the previous KLOEs. These have an austerity flavour and are more concerned with the current focus on issues such as savings and efficiencies.
<ul style="list-style-type: none"> ■ Strong emphasis on the need to demonstrate impact and positive outcomes to achieve higher scores. 	<ul style="list-style-type: none"> ■ Focus is on the adequacy of the arrangements to deliver economy, efficiency and effectiveness in the use of resources.
<ul style="list-style-type: none"> ■ Some cyclical variation each year, but UoR audits were applied in the same way at every audited body. 	<ul style="list-style-type: none"> ■ Risk-based approach with the level of audit work varying at each audited body.

Our work this year on your use of resources arrangements will follow a new approach introduced by the Audit Commission.

Background to new approach to local VFM work

The financial environment in which public sector audited bodies operate has changed significantly in the last two years. In particular, the recession, the state of the UK's public finances, and the scale of funding cuts have led to increased pressure on public spending.

In response to the changing financial environment, the Audit Commission has introduced a new approach to local VFM work at those bodies previously subject to a UoR assessment. The new, more focused approach will focus the work auditors do on areas of identified audit risk to meet their statutory VFM responsibilities.

The principles the Commission has used to develop the new approach to local VFM audit work are that it should:

- enable auditors to fulfil their responsibility under the Act and the Code, relating to an audited body's arrangements to secure economy, efficiency and effectiveness;
- be sharper and more focused than the UoR assessment, enabling a reduction in audit work and audit fees (although this will vary at individual bodies, so the actual level of work and fees may reduce, stay the same or even increase depending on the auditor's risk assessment) and allow for greater linkages to our financial statements audit work; and
- apply proportionately to reflect the size, capacity and performance of different types of audited body and, as far as possible, operate consistently across all sectors of the Commission's regime.

In meeting their statutory responsibilities relating to economy, efficiency and effectiveness, the Commission's Code requires auditors to:

- plan their work based on consideration of the significant risks of giving a wrong conclusion (audit risk); and
- carry out only as much work as is appropriate to enable them to give a safe VFM conclusion.

The new approach is structured under two themes, as summarised below.

Specified criteria for VFM conclusion	Focus of the criteria	Sub-sections
The organisation has proper arrangements in place for securing financial resilience .	The organisation has robust systems and processes to: <ul style="list-style-type: none"> ■ manage effectively financial risks and opportunities; and ■ secure a stable financial position that enables it to continue to operate for the foreseeable future. 	<ul style="list-style-type: none"> ■ Financial governance ■ Financial planning ■ Financial control
The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness .	The organisation is prioritising its resources within tighter budgets, for example by: <ul style="list-style-type: none"> ■ achieving cost reductions; and ■ improving efficiency and productivity. 	<ul style="list-style-type: none"> ■ Prioritising resources ■ Improving efficiency and productivity

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

Overview of the VFM audit approach

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





Each of these stages are summarised further below.

VFM audit stage	Audit approach
	<p>VFM audit risk assessment</p> <p>We will consider the relevance and significance of the potential business risks faced by all local authorities, and other risks that apply specifically to the Council. These are the significant operational and financial risks in achieving statutory functions and objectives, which are relevant to auditors' responsibilities under the Code.</p> <p>In doing so we will consider:</p> <ul style="list-style-type: none"> the Council's own assessment of the risks it faces, and its arrangements to manage and address its risks; Information from the Audit Commission's VFM profile tool and financial ratios tool; evidence gained from previous audit work, including the response to that work; and the work of the Audit Commission, other inspectorates and review agencies (where relevant to our VFM audit responsibilities).

Our VFM audit will draw heavily on other audit work which is relevant to our VFM responsibilities and the results of last year's VFM audit .



We will then form an assessment of residual audit risk to identify the areas where more detailed VFM audit work is required.

Overview of the VFM audit approach (continued)

VFM audit stage	Audit approach
 <p data-bbox="561 434 679 511">Financial statements audit</p>	<p data-bbox="857 382 1504 404">Linkages with financial statements and other audit work</p> <p data-bbox="857 411 2001 518">There is a degree of overlap between the work we do as part of the VFM audit and our financial statements audit. For example, our financial statements audit includes an assessment and testing of the Council's financial management and governance arrangements, many aspects of which are relevant to our VFM audit responsibilities.</p> <p data-bbox="857 525 2001 661">We have always sought to avoid duplication of audit effort by integrating our financial statements and VFM work, and this will continue. We will therefore draw upon relevant aspects of our financial statements audit work to inform the VFM audit. In practice, this work will involve a range of interviews with relevant officers, review of documents such as policies, plans and minutes, and testing of certain controls. We will make use of any self assessment the Council undertakes against the detailed characteristics.</p> <p data-bbox="857 668 1918 718">We will also have regard to the results of previous VFM audit work and any other relevant audit work undertaken in the year.</p>
 <p data-bbox="571 838 671 886">Residual audit risk</p>	<p data-bbox="857 761 1243 782">Assessment of residual audit risk</p> <p data-bbox="857 796 1968 875">It is possible that our financial statements audit and previous VFM audit work may provide the assurance we need for the VFM audit. However, it is likely that further audit work will be necessary in some areas to ensure comprehensive coverage of the two VFM criteria.</p> <p data-bbox="857 889 1991 968">To inform any further work we must draw together an assessment of residual audit risk, taking account of the work undertaken already. This will identify those areas requiring further specific audit work to inform the VFM conclusion.</p> <p data-bbox="857 982 1997 1089">In doing so, we will identify the most appropriate approach to address each residual audit risk that has been identified. At this stage it is not possible to indicate the number or type of residual audit risks that might require additional audit work, and therefore the overall scale of work cannot be easily predicted. However, the range of options open to auditors are summarised on the next page.</p>



We will identify what additional VFM audit work is required and, where relevant, draw upon the range of audit tools and review guides developed by the Audit Commission.

Overview of the VFM audit approach (continued)

VFM audit stage	Audit approach
 <p>Identifying further work</p>	<p>Identification of specific VFM audit work</p> <p>It is possible that we may not identify any residual audit risks and instead have obtained all the evidence and assurance required from our financial statements and other audit work. If so, no further work will be necessary prior to issuing the VFM conclusion. If we do identify residual audit risks, then we will consider the most appropriate audit response in each case, including:</p> <ul style="list-style-type: none"> ▪ highlighting the risk to the Council; ▪ deferring any work because of current or planned work by the body or the Audit Commission, other inspectorates and review agencies (and/or considering the results of such work); or ▪ carrying out local risk-based work to form a view on the adequacy of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources.
 <p>Local risk-based work</p>	<p>Delivery of local risk based work</p> <p>Depending on the nature of the residual audit risk identified, we will be able to draw on the following audit tools and sources of guidance when undertaking specific local risk-based audit work:</p> <ul style="list-style-type: none"> ▪ local savings review guides based on selected previous Audit Commission national studies; and ▪ update briefings for previous Audit Commission studies. <p>These are discussed in further detail in Appendix A. Any detailed work will also make reference to the detailed VFM characteristics, as appropriate, and any self assessment the Council may prepare against the characteristics.</p> <p>The tools and guides will support our work where we have identified a local risk that is relevant to them. For any residual audit risks that relate to issues not covered by one of these tools, we will develop an appropriate audit approach drawing on the detailed VFM guidance and other sources of information. We will also consider the results of our follow up audit work on last year's Public Interest Report.</p>

The output of the VFM audit is our opinion on the arrangements in place to deliver VFM, known as the VFM conclusion.

Overview of the VFM audit approach (continued)

VFM audit stage	Audit approach
	<p>Concluding on VFM arrangements</p> <p>At the conclusion of the VFM audit we will consider the results of the work undertaken and assess the assurance obtained against each of the VFM themes regarding the adequacy of the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources.</p> <p>If any issues are identified that may be significant to this assessment, and in particular if there are issues that indicate we may need to consider qualifying our VFM conclusion, we will discuss these with management as soon as possible. Such issues will also be considered more widely as part of KPMG's quality control processes, to help ensure the consistency of auditors' decisions.</p>
	<p>Reporting</p> <p>We do not plan to produce a separate report on the VFM audit, either overall or for any local savings reviews that we may undertake. Instead, we will report on the results of the VFM audit through our Interim Audit Report and our Report to those charged with governance. These reports will summarise our progress in delivering the VFM audit, the results and any specific matters arising, and the basis for our overall conclusion.</p> <p>The key output from the work will be the VFM conclusion (i.e. our opinion on the Council's arrangements for securing VFM). This will be delivered through the audit report that we issue on the Council's financial statements.</p> <p>The VFM conclusion will be one of the following:</p> <ul style="list-style-type: none"> ■ unqualified – meaning we are happy that in all significant respects the Council has proper arrangements for securing economy, efficiency and effectiveness in the use of its resources; or ■ except for qualification – meaning we are generally satisfied with the adequacy of the arrangements in place, except for one or more specific issues highlighted during the audit that relate to specific VFM criteria; or ■ meaning we conclude that the Council does not have adequate arrangements in place. <p>In practical terms, issues that would have led to a level 1 score under the previous UoR regime will continue to require auditors to consider the need for some form of qualification of the VFM conclusion.</p>

The Audit Commission has developed a range of VFM tools and review guides that we can draw upon when undertaking VFM audit work on any detailed risk areas.

The local savings reviews are light-touch guides, with comparative data where available. Use of the tools and review guides is not mandatory and auditors are not therefore required to undertake work on the topics covered as a matter of course. The tools and guides will support auditors' work where we have identified a local risk through the risk assessment. Also, they can be applied flexibly so we may decide to only use them in part rather than fully, depending on the nature of the residual audit risk to be addressed.

Local savings review guides

The Audit Commission has developed the following local savings review guides which auditors can use to inform local VFM work on appropriate residual audit risks.

Review Guide	Description
<p>Back to front: efficiency of back office functions in local government</p> <p>Link</p>	<p>The original 2008 national study found there were still opportunities for back office savings. The savings review guide focuses on arrangements to deliver savings including delivery arrangements, governance processes, plans and good information.</p> <p>The results of work on this topic may provide evidence for the VFM conclusion criterion on how organisations are challenging the way they secure economy, efficiency and effectiveness.</p>
<p>The efficiency challenge: the administration costs of revenues and benefits</p> <p>Link</p>	<p>The 2005 national study identified potential efficiency savings of £140 million. The savings review guide focuses on the arrangements needed to deliver these potential savings, including:</p> <ul style="list-style-type: none"> delivery arrangements (for example in-house, contracted out or shared); governance; and good information. <p>The results of work on this topic may provide evidence for the VFM conclusion criterion on how organisations are challenging the way they secure economy, efficiency and effectiveness.</p>

Audit Commission national study update briefings

The Audit Commission has developed the following national study update briefings which auditors can use to inform local VFM work on appropriate residual audit risks:

- [Room for improvement: A review of strategic asset management](#); and
- [Positively charged: maximising the benefits of local public service charges](#).

If used, these update briefings will be useful when considering whether the Council is using sources of good practice to challenge arrangements for securing VFM (see securing economy, efficiency and effectiveness criterion). The *Positively charged* update briefing may also be relevant to the financial resilience criterion.



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