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Report to those charged with governance (ISA 260) 2011/12

Cheltenham Borough Council

September 2012

Contents

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Introduction

This report summarises:

- **the key issues identified during our audit of Cheltenham Borough Council's ('the Council's) financial statements for the year ended 31 March 2012; and**
- **our assessment of the Council's arrangements to secure value for money (VFM) in its use of resources.**

We do not repeat matters we have previously communicated to you. In particular, we draw your attention to our *Interim Audit Report 2011/12*, presented to you in June 2012, which summarised our planning and interim audit work.

Financial statements

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

Planning → Control Evaluation → Substantive Procedures → Completion

We previously reported on our work on the first two stages in our *Interim Audit Report 2011/12* issued in June.

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 we have identified since we issued our *Interim Audit Report 2011/12*.

Our final accounts visit on site took place between 02/07/2012 and 20/07/2012. During this period, we carried out the following work:

Substantive Procedures

- Planning and performing substantive audit procedures.
- Concluding on critical accounting matters.
- Identifying audit adjustments.
- Reviewing the Annual Governance Statement.

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

Completion

- Declaring our independence and objectivity.
- Obtaining management representations.
- Reporting matters of governance interest.
- Forming our audit opinion.

VFM conclusion

We have also now completed our work in respect of the 2011/12 VFM conclusion. This included:

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

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out the key findings from our audit work in relation to the 2011/12 financial statements.
- Section 4 outlines the key findings from our work on the VFM conclusion.
- Section 5 outlines the audit handover process.

Our recommendations are included in Appendix 1. We have also reviewed your progress in implementing prior year recommendations and this is detailed in Appendix 2.

Acknowledgements

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

Headlines

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

Proposed audit opinion	We anticipate issuing an unqualified audit opinion by 30 September 2012. We also expect to report that the wording of your Annual Governance Statement accords with our understanding.
Audit adjustments	Our audit has identified a total of seven audit adjustments in respect of the Council. We have also identified an audit adjustment on the Consolidated Group accounts. Officers have corrected all except one of the adjustments. The impact of the corrected adjustments is to: ■ Increase the net worth of the Council as at 31 March 2012 by £0.685 million. ■ Decrease the net worth of the Group as at 31 March 2012 by £5.6 million. We have included a list of the corrected audit adjustments at Appendix 3. We have also included a schedule to detail the uncorrected audit adjustment at Appendix 3. We have raised a number of recommendations in relation to the matters highlighted above, which are summarised in Appendix 1.
Critical accounting matters	We have worked with Officers throughout the year to discuss specific risk areas. The Council has addressed the non 'GO' associated recommendations appropriately in the year. However there were several recommendations that required GO to be implemented to be fully and these will be reviewed during the 2012/13 audit.
Accounts production and audit process	Your finance team have prepared this year's accounts in the face of the pressures and resource restraints following the implementation of GO and going 'live' from 1 April 2012. We had discussed the risks with Audit Committee during the planning stages of the audit. As a result of the pressures, there has been a decline in the quality of the accounts and the supporting working papers this y ear. Officers have worked with us to deal our audit queries, however the completion of the audit has taken longer than in prior years as a result of the increased number of issues. The Council has implemented the majority of the recommendations in our *ISA 260 Report 2010/11* relating to the financial statements.
Completion	At the date of this report, our audit of the financial statements is complete. Before we can issue our opinion we require a signed management representation letter. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Council's financial statements.
VFM conclusion	We have concluded that the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2012.

Proposed opinion and audit differences

Our audit has identified a total of six audit adjustments in the Council accounts and one in respect of the consolidated accounts.

The impact of these adjustments is to:

- **Increase the net worth of the Council as at 31 March 2012 by £0.7 million.**
- **Decrease the net worth of the Group as at 31 March 2012 by £5.6 million.**

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion by 30 September 2012.

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.

Our audit identified a total of six audit differences, which we set out in Appendix 3. These have all been adjusted in the final version of the financial statements.

We have identified one unadjusted audit difference which relates to the £0.36 million heritage asset additions in year. This item is not material and further details have been given in Appendix 3.

The tables on the right illustrate the total impact of audit differences on the Council's movements on the General Fund for the year and balance sheet as at 31 March 2012.

Council account - Movements on the General Fund 2011/12

£m	Pre-audit £'000	Post-audit £'000	*Ref (App.3)*
Deficit on the provision of services	(25,038)	(25,038)	
Adjustments between accounting basis & funding basis under Regulations	23,330	23,330	
Transfers earmarked reserves	0	0	
Decrease in General Fund	**(1,708)**	**(1,708)**	

Council only Balance - Sheet as at 31 March 2012

£m	Pre-audit £'000	Post-audit £'000	*Ref (App.3)*
Property, plant and equipment	233,286	236,384	No 2
Other long term assets	57,220	57,905	No 1
Current assets	14,805	11,721	No 2
Current liabilities	(18,832)	(18,832)	
Long term liabilities	(101,413)	(101,413)	
Net worth	**185,066**	**185,765**	
General Fund	(2,253)	(2,253)	
Other reserves	(182,813)	(183,512)	No 1,2
Total reserves	**(185,066)**	**(185,765)**	

Proposed opinion and audit differences (continued)

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

In addition, we identified a number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting the United Kingdom 2011/12 ('the Code')*. We understand that the Council will be addressing these where significant.

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 Council addressed the issues appropriately.

In our *External Audit Plan 2011/12*, presented to you in June, we identified the key risks affecting the Council's 2011/12 financial statements.

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

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

Key audit risks	Issue	Audit findings
Savings plans	As at December 2011, the Council is forecasting that it will deliver its 2011/12 budget in overall terms. With continued pressure to deliver the required level of public sector cuts, this may increase the risk of management bias on the financial statements, for example reducing the levels of provisions and liabilities. If there are any liabilities arising from the savings plans at year end, these will need to be accounted for in the 2011/12 financial statements as appropriate.	In conjunction with our VFM work we have critically assessed the controls the council had in place to ensure a sound financial standing. We confirmed that its Medium Term Financial Plan had duly taken into consideration the funding reductions and that it was sufficiently robust to ensure that the Council continued to provide services effectively. We reviewed the Council's arrangements in place for securing economy, efficiency and effectiveness in your use of resources during our value for money audit. See page 10 for further commentary on the VFM conclusion work. During the final audit visit, we reviewed the liabilities as at the year end and discussed the movements in provisions and we are satisfied that the balances are not materially misstated.
GO project	As the GO project progresses towards completion, the Council's resources will become further stretched as staff will be asked to take on additional roles in the lead up to the GO Live 'date'. This may have an adverse impact on the Council control environment. The accounting for the GO project involves decisions as to whether project costs should be treated as Capital or Revenue. We will also review the accounting for the Council re-charging costs to its partners.	There has been a decline in the quality of the accounts and supporting working papers this year. This is a direct result of the pressures on the finance team in managing the Council's migration to Agresso as part of the transition to 'GG' on the 1 April 2012, at the same time as drafting the year end financial statements and preparing for the audit. We have reviewed the accounting policy and treatment of the project costs together with the assumptions behind the treatment during our Interim audit and are satisfied that the accounting treatment is appropriate and not materially misstated. We have not identified any significant control failures as a result of the transition to GO. However the finance team has been put under increased pressure and this has been seen in the quality of the working papers. As the transition to Agresso occurred on the 1 April 2012, we have not reviewed either the design or operating effectiveness of the controls within the new Agresso environment which will need to be addressed in the 2012/13 audit.

Critical accounting matters (continued)

Key audit risks	Issue	Audit findings
Code changes	The 2011/12 *Code* includes a number of accounting changes, including a new requirement to carry 'heritage assets' at valuation. Heritage assets include historical buildings, museum and gallery collections and works of art. The 2011/12 *Code* also clarifies requirements in a number of areas where ambiguity was identified in the 2010/11 *Code.* The Council needs to review and appropriately address these changes in its 2011/12 financial statements.	We reviewed the Council's approach to disclosing heritage assets within their financial statements in 2011/12. We consider that the Council has used an appropriate process to identify its heritage assets. The Council has £28.2 million heritage assets as at 31 March 2012, which is mainly the Museum collection. The Heritage assets have been correctly brought onto the balance sheet through a prior period adjustment which requires the disclosure of a 'third' balance sheet in the accounts. We identified an audit adjustment of £0.69 million where some heritage assets had not been included in the calculations, and officers have corrected the final accounts accordingly. See appendix 3. We also identified a further £0.36 million audit difference in relation to the treatment of heritage asset additions in the year. This item was not corrected, and more details on this difference can be found in Appendix 3. The Code requires that heritage assets are held at valuation and that the valuation is regularly revisited. Cheltenham's most recent valuation was in 2009 ,which has been uplifted for inflation in subsequent years. We have raised a recommendation that the Council should carry out regular valuations, see Appendix 1.

Accounts production and audit process

There has been a decline in the quality of the accounts and the supporting working papers as a result of the increased pressure placed on the finance team with the transition to 'Go' on 1st April 2012.

Officers dealt with audit queries as efficiently as possible but there have been delays in the audit process as a result of the number of queries and the need to work around holiday leave.

The Council has implemented the majority of the recommendations in our *ISA 260 Report 2010/11* relating to the financial statements.

Accounts production and audit process

ISA 260 requires us to communicate to you our views about the significant qualitative aspects of the Council's accounting practices and financial reporting. We also assessed the Council'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	We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 29 June 2012.
Quality of supporting working papers	Our *Accounts Audit Protocol*, which we issued in June 2012 and discussed with Sarah Didcote, set out our working paper requirements for the audit. The quality of working papers provided was variable and overall met the standards specified in our *Accounts Audit Protocol* ,but did lead to additional audit queries being raised.
Response to audit queries	Officers resolved the majority of audit queries in a reasonable time. In some cases, however, we experienced delays, specifically around support for the heritage asset valuations.
Group audit	To gain assurance over the Council's group accounts, we have obtained the audited financials statements of Cheltenham Borough Homes and Gloucester Airport Limited. We have completed additional audit testing on Gloucester Airport valuation. There are no specific matters to report pertaining to the group audit.

Prior year recommendations

In our *Interim Audit Report 2011/12* we commented on the Council's progress in addressing the recommendations in our *ISA 260 Report 2010/11.*

The Council has now implemented the majority of the recommendations in our ISA 260 Report 2010/11 relating to the financial statements.

Appendix 2 provides further details.

Completion

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

Before we can issue our opinion we require a signed management representation letter.

Once we have finalised our opinions and conclusions we will prepare our *Annual Audit Letter* and close our audit.

Declaration of independence and objectivity

As part of the finalisation process we are required to provide you with representations concerning our independence.

In relation to the audit of the financial statements of Cheltenham Borough Council for the year ending 31 March 2012, we confirm that there were no relationships between KPMG LLP and 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.

We have provided a detailed declaration in Appendix 4 in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Director of Resources, a draft of which is reproduced in Appendix 5. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

ISA 260 requires us to communicate to you by exception 'audit matters of governance interest that arise from the audit of the financial statements' which include:

- significant difficulties encountered during the audit;
- significant matters arising from the audit that were discussed, or subject to correspondence with management;
- other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process; and
- matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. significant deficiencies in internal control; issues relating to fraud, compliance with laws and regulations, subsequent events etc.).

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Council's 2011/12 financial statements.

VFM conclusion

Our VFM conclusion considers how the Council secures financial resilience and challenges how it secures economy, efficiency and effectiveness.

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

Background

Auditors are required to give their statutory VFM conclusion based on two criteria specified by the Audit Commission. These consider whether the Council has proper arrangements in place for:

- securing financial resilience: looking at the Council's financial governance, financial planning and financial control processes; and
- challenging how it secures economy, efficiency and effectiveness: looking at how the Council is prioritising resources and improving efficiency and productivity.

We follow a risk based approach to target audit effort on the areas of greatest audit risk. We consider the arrangements put in place by the Council to mitigate these risks and plan our work accordingly.

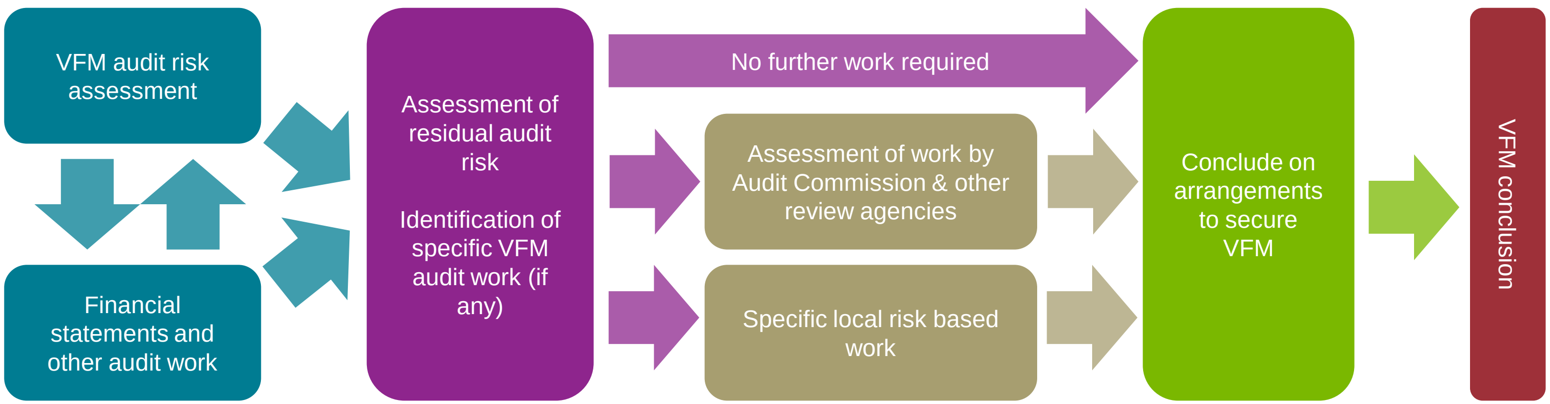
The key elements of the VFM audit approach are summarised in the diagram below.

Conclusion

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

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

We reported our risk assessment in our Interim Audit Report 2011/12. As we were satisfied that in all cases, sufficient work in relation to these risks had been carried out by the Council, the Audit Commission, other inspectorates or review agencies to mitigate the residual audit risks for our VFM conclusion, we concluded that we did not need to carry out any specific additional work ourselves.



Specific VFM risks

We have now concluded our specific work in relation to the residual risks we identified following our initial risk assessment.

Our general audit work provides us with good assurance over the Council's general arrangements for securing economy, efficiency and effectiveness.

We identified the residual audit risks for our VFM conclusion, and set out our preliminary assessment of these with reference to the relevant work by the Council, the Audit Commission, other inspectorates and review agencies.

We concluded that we needed to carry out additional work for some of these risks and this work is now complete. The outcome of this work is set out below.

Key VFM risk	Preliminary assessment	Key findings of our additional work
Savings plan	We need to consider in more detail the process used by the Council to put together the savings plan and monitor progress against it.	Management have monitored the savings plan closely through their 'Bridging the Gap' programme board. The savings have been reported at regular intervals to the Cabinet with explanations of progress of achieving the separately identified savings. These savings are risk assessed and savings that have been delivered are removed from the base budgets. The levels of detail provided in the reports indicate that management understand the costs of delivery and are achieving the savings required. This is further evidenced by the under spend on the general fund for 2011/12.
GO project	As the GO project progresses towards completion we need to review the process used by the Council to identify and ensure delivery of the identified savings.	The Council has always forecast that savings for the GO project would be realised during 2013/14 and therefore it is not possible to review the achievement of these savings at this time. However, management have achieved the transition to Agresso within the planned timescale and are currently undertaking a staff restructure to ensure the level of resources are at an appropriate level for the GO environment.

Process and timeline to handover to new audit auditors

This table summarises the approach and timetable of the audit handover

Overall	The Audit Commission has set deadlines for this work to be completed and for the work to be handed over to the new auditors Grant Thornton. These deadlines are set out below in each section. The Audit Commission has a set process which needs to be followed when audits are transferred between auditors. Generally, the process will commence with a meeting between incoming auditors, Grant Thornton, and the outgoing auditors, KPMG to discuss the audit and will provide copies of any requested documents and also access to our 2011/12 working papers, which will allow the audit to transition smoothly to Grant Thornton. KPMG will remain in place until Grant Thornton is appointed and any queries which arise before the formal handover need to be discussed with KPMG on a timely basis, if it relates to 2011/12 year. KPMG will then consider whether it is appropriate for us to take action or to hand over to Grant Thornton. If the issues relate to 2012/13 year, then it should first be discussed with KPMG but we would forward the issue to Grant Thornton as it relates to their first year of audit.
Financial statement and VFM audit	The deadlines for the financial statement audit opinions to be provided is 30 September 2012. The Audit Committee is scheduled for 19 September and it is planned that the Audit report will be signed on this day which will cover both the financial statement and VFM audit opinions.
WGA opinion	The audit work for the WGA will be completed before the Audit Committee and will be signed at the same time as the financial statement audit opinion.
Grant audits	The grant audits for the year ended 31 March 2012 including the Housing Benefit Count audits, NNDR and Housing Subsidy are currently being completed and KPMG has been given the deadline of the 26 October 2012 to have all the grant audit work completed. The work is currently on track to meet this deadline which is a month earlier than the normal.
Elector challenge	We are currently reviewing potentially two elector challenges and this work will be completed by KPMG before Grant Thornton is appointed.

Appendix 1: Key issues and recommendations

We have given each recommendation a risk rating and agreed what action management will need to take.

The Council should closely monitor progress in addressing specific risks and implementing our recommendations.

Priority rating for recommendations		
❶ ***Priority one***: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	❷ ***Priority two***: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	❸ ***Priority three***: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
1	❷	**No regular revaluation of heritage assets** Heritage assets were brought onto the Council's balance sheet in 2011/12 inline with the Code. However during our review of heritage assets it became clear that the last valuation was undertaken in 2009. The Code recommends regular valuations and therefore we suggest that the Council reviews its policy for revaluing its heritage assets to ensure they are completed on a regular basis.	**Responsible officer –Martyn Scull/David Roberts** The policy for revaluation of heritage assets is to be reviewed to ensure regular revaluations take place in order to be reflected in the Council's balance sheet. **Due date- 31/03/2013**
2	❷	**Timeliness of bank reconciliations** Our review of the September 2011 and March 2012 bank reconciliations revealed that whilst the bank reconciliations had been completed and all items reconciled there was a delay in the review of the reconciliations. The March bank reconciliation was not reviewed until July due to resource constraints within the Finance team following the implementation of GO. We therefore recommend that bank reconciliations are prepared and reviewed as part of the month end closedown to ensure any issues that arise on the new system are dealt with and cleared on a timely basis.	**Responsible officer – GO Corporate team member** The bank reconciliation will be reviewed as part of the month end closedown process to ensure that issues are dealt with on a timely basis. **Due date – 31/10/2012**

Appendix 2: Follow up of prior year recommendations

The Council has not implemented all of the recommendations in our *ISA 260 Report 2010/11.*

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

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2010/11* and re-iterates any recommendations still outstanding.

As a result of the change in the accounting system and transition to GO on 1 April 2012, several of the recommendations from our 2010/11 interim report are no longer relevant as they relate to the accounting system in place during 2011/12. The controls within the new accounting system Agresso will need to be tested during the 2012/13 interim audit.

Number of recommendations that were:	
Included in original report	3
Implemented in year or superseded	1
Remain outstanding (re-iterated below)	2

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at July 2012
1	2	**Issue–access to Live Environment not restricted for Open Revenues and Icon** When organisations develop and test new IT applications, they usually do so in a part of the system (“the Development Environment”) that can only be accessed by the IT development team. When the development team has checked the new application for errors and bugs, they release the application for general use by council staff in “the Live Environment”. Staff should not be able to make changes to applications in the Live Environment, or there is a risk of programming errors creating errors in transactions. We identified that all users have the ability to access network folders containing the Open Revenues and Icon live environment files, which increases the risk of the application files being accidentally or otherwise overwritten or deleted. **Recommendation** The Council should review access rights to live environment folders and ensure that they are restricted appropriately for all systems including the new Agresso system when it is introduced in 2012.	**Responsible officer –Paul Woolcock, ICT Infrastucture Manager** Applications may require access to the program files held on a shared drives. Permissions are being checked on shared and folders, as some applications will only run with 'full control' access. ICT will get clarification with the Agresso suppliers on folder and file permissions prior to going live in 2012.	**In progress** Clarification was obtained from the Agresso suppliers prior to the system going live in 2012. Permissions to live environment folders have now been restricted to the IT development team.

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

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at July 2012
2	2	**Issue–Lack of evidence of review of Benefits payments run.** The Benefits System automatically generates a list of payments due each week. Benefits Officers have the ability to suspend payments to individuals for a range of reasons for example if it is suspected that the individual is not entled to the benefit they are claiming. As part of the control process, the system produces a Suspended Payment Report and these reports are reviewed. However the reports are not printed out and therefore no audit trail exists of the management review which is an important part of the control process. **Recommendation** The suspended payments reports are signed and dated as evidence of the review process.	**Responsible officer-Paul Aldridge, Housing Benefit Manager** The Benefit service have put into place processes for staff to ensure the printing, checking and validating of reports (signature and date) before payments are made. Hard copies will be kept on file.	**Implemented.**

Appendix 2: Follow up of prior year recommendations

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at July 2012
3	3	**Issue –Lack of evidence of review of journals** A journal is a mechanism used in accounting systems for making adjustments and corrections. If not used carefully, there is a risk that they can create errors. In order to control this risk, it is best practice that journals should be reviewed and signed off by a more senior staff member. The higher the financial value on the journal, the more senior should the sign off be. We noted that currently there is no formal review of journals. A system of secondary authorisation/approval at least for higher value journals would provide assurance that only genuine journals are being posted. We recognise that the Council has high level budgetary controls in place as a compensating control but do no feel that this is at the right level to pick up journal errors. Currently the Council has a proven and trusted finance team in place however in moving forwards to GO shared services the secondary authorisation of journals will become more imperative. **Recommendation** Higher value journals are authorised and evidence of this authorisation is maintained.	**Responsible officer-Paul Jones, Head of Financial services** In 2011/12 it is agreed that all Journals exceeding £100,000 are countersigned by the Head of Financial Services or the Director of Resources. All journal entries into the new Financial Management system (Agresso) which is due to go 'live' on 1st April 2012, may only be processed by authorised employees with the approval of the Section 151 Officer. The Head(s) of Finance for GO Shared Services will be responsible for ensuring that a daily report of all journals raised on the new finance system is produced and retained for audit purposes. This report will be checked and signed as agreed by a delegated senior officer within GO Shared Services.	**In progress** For journals greater than £100,000 a retrospective review is undertaken. During the monthly close down any unusual journals which have been posted that month are also reviewed. We recommend that the Audit Committee follow this up during the 2012/13 audit.

Appendix 3: Audit differences

This appendix sets out the significant 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 the Council'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

The following table sets out the significant audit differences identified by our audit of Cheltenham Borough Council's financial statements for the year ended 31 March 2012.

All the adjustments in this section have been amended in the final version of the financial statements.

	Impact					Basis of audit difference
No.	Income and Expenditure Statement	Movement in Reserves Statement	Assets	Liabilities	Reserves	
1	-		Dr Heritage assets £685k	-	Cr Revaluation reserve £685k	A review of the most recent valuation for heritage assets identified three assets that had been included on the valuation report from the valuer but had not been included in the financial statements. This resulted in heritage assets being understated by £685k.
2	-	-	Dr Surplus assets £3,084k	Cr Assets held for sale £3,084k	-	Assets held for sale contained land and buildings where the sale was subject to planning permission. This did not comply with the Code's definition of assets held for sale and therefore the land and buildings in question have been re-classified as surplus assets.
3	-	-	Dr Surplus assets £588k	Cr Council dwellings £588k	-	A number of council dwellings which were being assessed in 2010/11 have now been identified as surplus assets. This was accounted for as a prior period adjustment, however as the issue was identified during 2011/12 the adjustment should be made in the 2011/12 financial statements.

Appendix 3: Audit differences (continued)

	Impact					
No.	**Income and Expenditure Statement**	**Movement in Reserves Statement**	**Assets**	**Liabilities**	**Reserves**	**Basis of audit difference**
4	-	-	Dr Other land & buildings £2,990k	Cr Assets under construction £2,990k	-	Construction work is currently taking place at the Art Gallery and Museum which has resulted in the temporary closure of the building. The asset had been transferred to assets under construction from other land and buildings. The original assets should have remained in other land and buildings with only the eligible construction work being shown as assets under construction.
5	-	-	Dr Net gain/(losses) from fair value adjustments £563k	Cr Disposals £563k	-	Officers identified that one of the assets that had been revalued and part disposed of in year had the incorrect amount recorded as disposal and revaluation in the draft financial statements. This adjustment had no overall impact on the investment property balance.
	£0	**£0**	**Dr£2,574k**	**Cr£1,889k**	**Cr£685k**	**Impact on Council and Group accounts**
6	-	-	Dr Long term debtors £1,195k	Cr Long term investments £1,195k	-	The Council has loaned Gloucestershire Airport £1,195k in 2011/12. The loan was incorrectly accounted for as an investment.
	£0	**£0**	**Dr £3,769k**	**Cr £3,084k**	**Cr £685k**	**Total impact of Council accounts**

Appendix 3: Audit differences (continued)

No.	Impact: Income and Expenditure Statement	Impact: Movement in Reserves Statement	Impact: Assets	Impact: Liabilities	Impact: Reserves	Basis of audit difference
Group Accounts **The audit adjustments 1 to 5 listed above also impact the group accounts**						
1-5 from above	**£0**	**£0**	**Dr£2,574k**	**Cr£1,889k**	**Cr£685k**	**Impact on Council and Group accounts (see previous page)**
1	-	-	Cr Group joint venture £6,285k	-	Dr Group revaluation reserve £6,285k	The valuation for Gloucestershire Airport was received after the draft financial statements had been released to audit. Therefore this adjustment is required to the Group financial statements so that it reflects the latest valuation.
	£0	**£0**	**Cr £3,711k**	**Cr£1,889k**	**Dr £5,600k**	**Total impact of Group Account adjustments**

Appendix 3: Audit differences (continued)

We identified one uncorrected audit adjustment.

Uncorrected audit differences

The following table sets out the uncorrected audit difference identified by our audit of Cheltenham Borough Council's financial statements for the year ended 31 March 2012.

	Impact					
No.	Income and Expenditure Statement	Movement in Reserves Statement	Assets	Liabilities	Reserves	Basis of audit difference
1	Cr Expenditure £267k	Dr General Fund balance £267k	-	-	Dr Revaluation reserve £267k	Heritage asset additions had been accounted for incorrectly in year. Additions comprised £88k which had been paid for in cash and £267k of donated assets. The donated asset additions had not been accounted for in line with the Code. As the audit adjustment is not significant and has no impact on the General Fund balance the Council has chosen not to amend the financial statements.
	-	Cr Capital Adjustment account £267k	-	-	-	
	Cr £267k	**£0**	**£0**	**£0**	**£267k**	**Total impact of uncorrected audit differences**

Presentational issues

We identified a number of presentational issues during our audit and these have been amended by management.

Appendix 4: Declaration of independence and objectivity

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

Requirements

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

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

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

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

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

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from his. These matters should be discussed with the Audit Committee.

Ethical Standards require us to communicate to those charged with governance in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on our independence and the objectivity of the Audit Partner and the audit team.

General procedures to safeguard independence and objectivity

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

Appendix 4: Declaration of independence and objectivity (continued)

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 2012, we confirm that there were no relationships between KPMG LLP and 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 5: Draft management representation letter

We ask you to provide us with representations on specific matters such as whether the transactions within the accounts are legal and unaffected by fraud.

The wording for these representations is prescribed by auditing standards.

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

Dear Sirs

This representation letter is provided in connection with your audit of the financial statements of Cheltenham Borough Council ("the Authority") for the year ended 31 March 2012,B for the purpose of expressing an opinion:

i. as to whether these financial statements give a true and fair view of the financial position of the Authority and the Group as at 31 March 2012 and of the Authority's and the Group's expenditure and income for the year then ended; and

ii. whether the financial statements have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

These financial statements comprise the Authority and Group Movement in Reserves Statements, the Authority and Group Comprehensive Income and Expenditure Statements, the Authority and Group Balance Sheets, the Authority and Group Cash Flow Statements, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement and the Collection Fund and the related notes.

The Authority confirms that the representations it makes in this letter are in accordance with the definitions set out in the Appendix to this letter.

The Authority confirms that, to the best of its knowledge and belief, having made such inquiries as it considered necessary for the purpose of appropriately informing itself:

Financial statements

1. The Authority has fulfilled its responsibilities, as set out in regulation 8 of the Accounts and Audit (England) Regulations 2011, for the preparation of financial statements that:
   - give a true and fair view of the financial position of the Authority and the Group as at 31 March 2012 and of the Authority's and the Group's expenditure and income for the year then ended; and
   - have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

The financial statements have been prepared on a going concern basis.

2. Measurement methods and significant assumptions used by the Authority in making accounting estimates, including those measured at fair value, are reasonable.
3. All events subsequent to the date of the financial statements and for which the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 requires adjustment or disclosure have been adjusted or disclosed.
4. The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to this representation letter.

Information provided

5. The Authority has provided you with:
   - access to all information of which it is aware, that is relevant to the preparation of the financial statements, such as records, documentation and other matters;
   - additional information that you have requested from the Authority for the purpose of the audit; and
   - unrestricted access to persons within the Authority and Group from whom you determined it necessary to obtain audit evidence.
6. All transactions have been recorded in the accounting records and are reflected in the financial statements.

Appendix 5: Draft management representation letter (continued)

7. The Authority acknowledges its responsibility for such internal control as it determines necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In particular, the Authority acknowledges its responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

The Authority has disclosed to you the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

The Authority has disclosed to you all information in relation to:

(a) Fraud or suspected fraud that it is aware of and that affects the Authority and the Group and involves:

- management;
- employees who have significant roles in internal control; or
- others where the fraud could have a material effect on the financial statements; and

(b) allegations of fraud, or suspected fraud, affecting the financial statements communicated by employees, former employees, analysts, regulators or others.

8. The Authority has disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements.

9. The Authority has disclosed to you and has appropriately accounted for and/or disclosed in the financial statements in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.

10. The Authority has disclosed to you the identity of the Authority 's and the Group's related parties and all the related party relationships and transactions of which it is aware and all related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

Included in the Appendix to this letter are the definitions of both a related party and a related party transaction as the Authority understands them and as defined in IAS 24, except where interpretations or adaptations to fit the public sector are detailed in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

11. On the basis of the process established by the Authority and having made appropriate enquiries, the Authority is satisfied that the actuarial assumptions underlying the valuation of pension scheme liabilities are consistent with its knowledge of the business.

The Authority further confirms that:

a) all significant retirement benefits, including any arrangements that:

- are statutory, contractual or implicit in the employer's actions;
- arise in the UK and the Republic of Ireland or overseas;
- are funded or unfunded; and
- are approved or unapproved,

have been identified and properly accounted for; and

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

Appendix 5: Draft management representation letter (continued)

This letter was tabled and agreed at the meeting of the Audit Committee on 19 September 2012.

Yours faithfully

Chair of Audit Committee

Director of Resources

Appendix A to the management representation letter of Cheltenham Borough Council: Definitions

Financial statements

A complete set of financial statements comprises:

- Comprehensive Income and Expenditure Statement for the period
- Balance Sheet as at the end of the period
- Movement in Reserves Statement for the period
- Cash Flow Statement for the period
- Notes, comprising a summary of significant accounting policies and other explanatory information, and
- Balance Sheet as at the beginning of the earliest comparative period (ie a third Balance Sheet) when an authority applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

A local authority is required to present group accounts in addition to its single entity accounts where required by chapter nine of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

A housing authority must present:

- a HRA Income and Expenditure Statement; and
- a Movement on the Housing Revenue Account Statement.

A billing authority must present a Collection Fund Statement for the period showing amounts required by statute to be debited and credited to the Collection Fund .

For pension funds participating in the following pension schemes, pension fund accounts must be prepared by the local authority that administers the Pension Fund:

a) the Local Government Pension Scheme (in England and Wales)

b) the Local Government Pension Scheme (in Scotland).

For pension funds participating in the following pension schemes, pension fund accounts must be prepared:

a) the Firefighters' Pension Scheme for England

b) the Firefighters' Pension Scheme for Wales

c) the Police Pension Scheme in England and Wales.

The financial statements of a defined benefit pension fund and of police authorities and fire and rescue service authorities in England and Wales must contain:

a) A fund account disclosing changes in net assets available for benefits.

b) A net assets statement showing the assets available for benefits at the year end.

c) Notes to the accounts.

Material matters

Certain representations in this letter are described as being limited to matters that are material.

Omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature or size of the omission or misstatement judged in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor.

Appendix A to the management representation letter of Cheltenham Borough Council: Definitions (continued)

Error

An error is an unintentional misstatement in financial statements, including the omission of an amount or a disclosure.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

a) was available when financial statements for those periods were authorised for issue, and

b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Management

For the purposes of this letter, references to "management" should be read as "management and, where appropriate, those charged with governance".

Related party

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions or if the related party entity and another entity are subject to common control.

Related parties include:

a) entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the authority (ie subsidiaries);

b) associates;

c) joint ventures in which the authority is a venture;

d) an entity that has an interest in the authority that gives it significant influence over the authority;

e) key management personnel, and close members of the family of key management personnel; and

f) post-employment benefit plan (pension fund) for the benefit of employees of the authority, or of any entity that is a related party of the authority.

Key management personnel are all chief officers (or equivalent), elected members, chief executive of the authority and other persons having the authority and responsibility for planning, directing and controlling the activities of the authority, including the oversight of these activities.

The following are deemed not to be related parties by the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2010/11:

a) providers of finance in the course of their business in that regard and trade unions in the course of their normal dealings with an authority by virtue only of those dealings; and

b) an entity with which the relationship is solely that of an agency.

Related party transaction

Related party transaction is a transfer of resources or obligations between related parties, regardless of whether a price is charged. Related party transactions exclude transactions with any other entity that is a related party solely because of its economic dependence on the authority or the government of which it forms part.

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