cutting through complexity

Report to those charged with governance (ISA 260) 2014/15

Lincolnshire County Council

September 2015

Contents

The contacts at KPMG in connection with this report are:

Tony Crawley
Director
KPMG LLP (UK)

Tel: 0116 256 6067
tony.crawley@kpmg.co.uk

Mike Norman
Manager
KPMG LLP (UK)

Tel: 0115 935 3554
michael.norman@kpmg.co.uk

Tom Tandy
Assistant Manager
KPMG LLP (UK)

Tel: 0115 935 4480
thomas.tandy@kpmg.co.uk

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

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

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Tony Crawley, the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Trevor Rees (on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk). After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

Section one

Introduction

This document summarises:

- **the key issues identified during our audit of the financial statements for the year ended 31 March 2015 for the Authority; and**
- **The status of the work in assessing the Authority's arrangements to secure value for money.**

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Scope of this report

This report summarises the key findings arising from:

- our audit work at Lincolnshire County Council ('the Authority') in relation to the Authority's 2014/15 financial statements; and
- the work to support our 2014/15 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

We have separately issued our *Report to those charged with governance (ISA 260) 2014/15* in respect of the Pension Fund administered by the Authority in September 2015.

The report is to be discussed with the Audit Committee on 21 September 2015. We will provide the Committee at its meeting with an update on our proposed opinion on the accounts and value for money conclusion.

Financial statements

Our *External Audit Plan 2014/15*, presented to you in March 2015, set out the four stages of our financial statements audit process.

This report focuses on the third stage of the process: substantive procedures. Our on site work for this took place between June and August 2015.

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

VFM conclusion

Our *External Audit Plan 2014/15* explained our risk-based approach to VFM work. This included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion;
- considering the results of any relevant work by the Authority and other inspectorates and review agencies in relation to these risk areas; and
- carrying out additional risk-based work.

We are completing the final stages of our assessment, to enable us take into account the latest position on the risks identified through our work.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our audit work in relation to the 2014/15 financial statements of the Authority and the fund.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1.

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 for the Authority. Sections three and four of this report provide further details on each area.

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Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2015. The draft Annual Governance Statement is to be updated to reflect the current position on the significant control issues the Authority is facing. We will review the updated Statement and report our findings in our in our audit opinion.
Audit adjustments	Our audit identified two audit adjustments. The impact of these adjustments is to: ▪ decrease the deficit on provision of services for the year by £7.628 million; and ▪ decrease the net worth of the Authority as at 31 March 2015 by £57.823 million. We have included further detail on these audit adjustments at Appendix 2. Both adjustments stem from applying incorrect indices to uplift school building carrying values. Both of these misstatements are to adjusted by the Authority. We have raised one recommendations in relation to the matter highlighted above, which is summarised in Appendix 1.
Key financial statements audit risks	We review risks to the financial statements on an ongoing basis. We identified the following key financial statements audit risk in our 2014/15 External audit plan issued in March 2015. ▪ Accounting for Local Authority Maintained Schools. CIPFA have issued definitive clarification of existing guidance on significant entries to be included in the financial statements. We have worked with officers throughout the year to discuss this key risk and our detail findings are reported in section 3 of this report.
Accounts production and audit process	The Authority has well established processes in place for the production of its accounts and supporting working papers. The need to support the implementation of the new Agresso financial system has placed additional pressure on the finance team, and we noted that the quality in some areas of the accounts has not been to the usual high standard, most notably around the accounting entries and supporting working papers for Property, Plant and Equipment where we identified material accounting errors. Whilst the circumstances for this year's audit will not be repeated for 2015/16 we have made recommendations at Appendix 1 in relation to the issues encountered this year.
Completion	At the date of this report our audit of the financial statements is substantially complete subject to us: ▪ Director review; ▪ Checking the agreed changes to the statements have been processed correctly; and ▪ Clearing any residual audit queries as part our completion procedures. We will also require a signed management representation letter. We will update the Audit Committee at its meeting if any additional reporting issues are identified as part of the remaining work. 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.

VFM conclusion and risk areas	We identified the following VFM risks in our *External Audit Plan 2014/15* issued in March 2015. ▪ The Authority has undertaken, through its Future Delivery of Support Services project, major procurement exercises to re-award its contracts for Corporate Support Services and Property Services. These services are to be supplied by new providers and the five year contracts will become live from 1 April 2015. The Authority has also agreed a change to its pension fund administration provider. In view of the importance of these changes to the Authority's contracts we need continued assurance about the Authority's arrangements for the economy, efficiency and effectiveness criterion of the VFM conclusion. An integral component of these new arrangements has been the implementation of the new Agresso financial system. We have worked with officers throughout the year to update our risk assessment and carry out further audit work in relation to the Authority's arrangements for addressing these VFM risks. We have also considered your response to the significant medium term financial and operational risks faced and carried out further work to assess your arrangements for preparing a balanced and sustainable budget for 2016 onwards.. The Agresso programme has been very challenging for the Authority, with the Authority unable to ensure that there have been during 2015/16 effective processes for accurate and complete payments to creditors and staff. Fully effective financial management and reporting arrangements have also not been in place, with complete and up to date budget forecast information not expected to be available before the end of October 2015. The programme monitoring and control arrangements have continued to be in place beyond the originally planned end date of June 2015. We are continuing to review the risks in respect of the Agresso programme and the medium term financial outlook so that we can take into account the latest information available before finalising our VFM conclusion. This includes Internal Audit's report on the Financial Control Environment in 2015/16 and the updated Annual Governance Statement. We will update the Audit Committee at its 21 September 2015 meeting on our findings and conclusion. We expect to continue to need to carry out additional work reviewing the risks around your arrangements in 2015/16. Given the weaknesses in the financial control environment for the first half of the year we expect to plan a largely substantive approach to our 2015/16 audit. We will discuss these issues and any additional work required further with management in agreeing the *External Audit Plan 2015/16*.

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Financial Statements
Proposed opinion and audit differences

Our audit has identified two audit adjustments.

The audit adjustments have no impact on the general fund balance at 31 March 2015.

We identified a small number of presentational adjustments required to the financial statements and we understand the Authority will be addressing these where significant.

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Proposed audit opinion

We anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Audit Committee on 21 September 2015.

Audit differences

In accordance with ISA 260 we are required to report uncorrected audit differences to you. We also report any material misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities.

The final materiality (see Appendix 4 for more information on materiality) level for this year's audit was set at £19 million. Audit differences below £0.7m are not considered significant.

Our audit identified two significant audit differences in relation to capital accounting, which we have set out in Appendix 2. One of the differences was material in value. It is our understanding these will be adjusted in the final version of the financial statements approved by the Audit Committee. The Appendix also includes one non-material audit difference which management do not propose to correct.

The tables on the right illustrate the total impact of corrected audit differences on the Authority's movements on the General Fund for the year and balance sheet as at 31 March 2015.

The audit adjustments have no impact on the General Fund balance at 31 March 2015.

We identified a a small number of presentational adjustments required to correct errors or ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 ('the Code')*. We understand that the Authority will be addressing these where significant and there are no items that we need to draw your attention to in this report.

Movements on the General Fund 2014/15

£m	Pre-audit	Post-audit
Deficit on the provision of services	-£64.7	-£56.9
Adjustments between accounting basis & funding basis under Regulations	£77.1	£69.4
Transfers from earmarked reserves	-£8.9	-£8.9
Decrease in General Fund	**-£0.5**	**-£0.5**

Balance Sheet as at 31 March 2015

£m	Pre-audit	Post-audit
Property, plant and equipment	£1,353.4	£1,296.5
Other long term assets	£161.9	£161.9
Current assets	£223.8	£223.8
Current liabilities	-£86.6	-£86.6
Long term liabilities	-£1,361.4	-£1,361.4
Net worth	**£291.2**	**£234.2**
General Fund	£15.9	£15.9
Other usable reserves	£222.5	£222.5
Unusable reserves	£52.8	-£4.2
Total reserves	**£291.2**	**£234.2**

Proposed opinion and audit differences (continued)

The draft Annual Governance Statement is to be updated to reflect the current position on the significant control issues the Authority is facing. We will review the updated Statement and report our findings in our audit opinion.

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Annual Governance Statement

We reviewed the draft Annual Governance Statement presented to the Audit Committee in July 2015 to confirm that:

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

We provided feedback on the draft in respect of its format and content. The Statement is to be updated to reflect the current position on the significant control issues the Authority is facing. We will review the updated Statement, which is to be considered by the Audit Committee at its 21 September 2015 meeting, and report our findings in our in our audit opinion.

Financial Statements (continued)
Significant risks and key areas of audit focus

We have worked with the Authority throughout the year to discuss significant risks and key areas of audit focus

This section sets out our detailed findings on those risks

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In our *External Audit Plan 2014/15*, presented to you in March 2015, we identified the significant risks affecting the Authority's 2014/15 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

The table below sets out our detailed findings.

Significant audit risk	Issue	Findings
Accounting for local authority maintained schools	LAAP Bulletin 101 *Accounting for School Assets used by Local Authority Maintained Schools* issued in December 2014 was published to assist practitioners with the application of the Code in this respect. The challenges related to school assets owned by third parties such as church bodies and made available to school governing bodies under a variety of arrangements. This includes assets used by Voluntary-Aided (VA) and Voluntary-Controlled (VC) Schools as well as Foundation Schools. The Authority needed to review the agreements under which assets are used by VA/VC and Foundation schools and apply the relevant tests of control in the case of assets made available free of charge, or risks and rewards of ownership in the case of assets made available under leases. This is a key area of judgement and there was a risk that the Authority could incorrectly omit school assets from, or include school assets in, its balance sheet.	As part of our audit we discussed the latest guidance with managers and considered the judgements made. We reviewed the accounting entries resulting from these judgements, including any changes to previous accounting treatments. The changes and the Authority's reasoning are disclosed in the financial statements. There are no specific additional issues arising from our audit work in relation to this significant audit risk that we need to raise in this report.

Financial Statements (continued)
Significant risks and key areas of audit focus (continued)

In our *External Audit Plan 2014/15* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. These risk areas were Management override of controls and the Fraud risk of revenue recognition.

The table below sets out the outcome of our audit procedures and assessment on these risk areas.

Areas of significant risk	Summary of findings
Management override of controls Audit areas affected ■ All areas	Our audit methodology incorporates the risk of management override as a default significant risk. Management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We have not identified any specific additional risks of management override relating to this audit. In line with our methodology, we carried out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual. There are no matters arising from this work that we need to bring to your attention.
Fraud risk of revenue recognition Audit areas affected ■ None	Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. In our *External Audit Plan 2014/15* we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue. This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.

Financial Statements (continued)
Accounts production and audit process

The Authority has well established processes in place for the production of the accounts and supporting working papers.

We received a complete set of draft accounts on 9 June 2015.

Officers have worked hard to prepare the accounts whilst supporting the introduction of the new financial system.

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The quality in some areas of the accounts have not been to the usual high standard, most notably around the accounting entries and supporting working papers for Property, Plant and Equipment where we identified material accounting errors.

Accounts production and audit process

ISA 260 requires us to communicate to you our views about the significant qualitative aspects of the Authority's accounting practices and financial reporting. We also assessed the Authority's process for preparing the accounts and its support for an efficient audit.

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority has well established processes in place for the production of the accounts and supporting working papers The Authority has been pro-active during this year's financial reporting process in taking steps to 'declutter' some areas of the accounts by removing disclosure notes which were either not applicable to the Authority or deemed to be immaterial in nature or value. We will continue, as part of the 2015/16 audit planning, to discuss with officers any further opportunities to reduce the size of the document. We have not identified any concerns in relation to the Authority's accounting practices which we need to report to you.
Completeness of draft accounts	We received a complete set of draft accounts on 9 June 2015, ahead of the 30 June deadline.
Quality of supporting working papers	Our *Accounts Audit Protocol*, which we issued on 10 April 2015 and discussed with Assistant Head of Finance (Corporate) and Corporate & Capital Team Leader, set out our working paper requirements for the audit. The Authority provided the working papers specified in our *Accounts Audit Protocol* at the start of the audit and additional working papers were provided when requested.
Response to audit queries	Officers resolved the majority of audit queries in a reasonable time. In some cases, however, we experienced some delays for audit evidence, attributable in the main to the time taken for non finance staff to process our requests..

The accounts production process this year was carried out against a backdrop of implementing the new Agresso financial system which has placed significant additional pressure on the finance team. We noted that the quality in some areas of the accounts have not been to the usual high standard, most notably around the accounting entries and supporting working papers for Property, Plant and Equipment where we identified material accounting errors. These factors have lead to some areas of the audit taking longer to complete than originally planned.

Whilst the circumstances for this year's audit will not be repeated for 2015/16, with closedown to be carried out using the new Agresso system, we have made recommendations at Appendix 1 in relation to the issues encountered this year. Fully effective financial management and reporting arrangements have not been in place for the first half of 2015/16 and there have been difficulties in making accurate and complete payments to creditors and staff. These will require a higher than normal volume of in-year correcting entries in 2015/16 and the Authority needs to have effective arrangements for managing the clearance of the backlog of issues. We will follow these up with management ahead of the 2015/16 year-end, as well as planning for any specific issues in relation to the arrangements for closedown under the new financial system.

Financial Statements (continued)
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.

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 Lincolnshire County Council for the year ending 31 March 2015, we confirm that there were no relationships between KPMG LLP and Lincolnshire County Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff.

We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 4 in accordance with ISA 260. This includes on pages 18-19 our review of two engagements for tax services. We have concluded that our objectivity has not been compromised, and we have set out the background and reasoning.

Management representations letter

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 Executive Director – Finance and Public Protection for presentation to the Audit Committee. We require a signed copy of your management representations letter before we issue our audit opinion. The letter includes the Authority's reasons for not adjusting the financial statements for the non-significant audit differences summarised at Appendix 2.

Other matters

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

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

There are no 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 Authority's 2014/15 financial statements.

Section four

VFM conclusion

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

Our work is in progress and we will update the Audit Committee at its 21 September 2015 meeting on the results of this work and our proposed value for money conclusion.

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Background

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

- securing financial resilience: looking at the Authority's financial governance, financial planning and financial control processes; and
- challenging how it secures economy, efficiency and effectiveness: looking at how the Authority 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 Authority to mitigate these risks and plan our work accordingly.

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

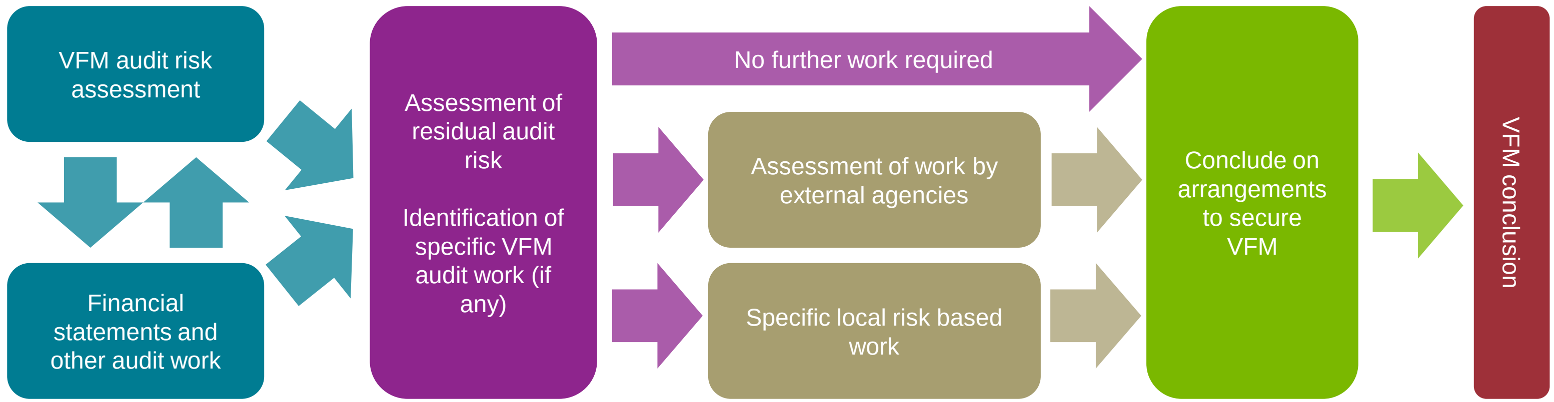
Work completed

We performed a risk assessment earlier in the year and have reviewed this throughout the year. Our assessment identified the programme for implementing Agresso and the medium term financial outlook as areas of significant risk.

We have worked with officers throughout the year to update our risk assessment and carry out further audit work in relation to the Authority's arrangements for addressing these VFM risks.

We are continuing to review the risks in respect of the Agresso programme and the medium term financial outlook so that we can take into account the latest information available before confirming our VFM conclusion. This includes Internal Audit's report on the Financial Control Environment in 2015/16 and the updated Annual Governance Statement. We will update the Audit Committee at its 21 September 2015 meeting on our findings, the proposed VFM conclusion and any recommendations arising from this work.

VFM criterion	Met?
Securing financial resilience	**To be confirmed**
Securing economy, efficiency and effectiveness	**To be confirmed**



Appendix 1: Key issues and recommendations

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

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

We will formally follow up these recommendations next year.

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.	Priority	Issue and recommendation	Management response / responsible officer / due date
1	❷	**Review of Property, Plant and Equipment (PPE) uplifting exercise** We identified material errors in the accounts resulting from the annual asset value uplifting exercise. We found that: • Of the 596 school building related assets which had been uplifted, 517 had been uplifted with the incorrect index, of which 311 had been uplifted by an index of over 40%. • some school buildings had been omitted from the uplifting exercise. These included all Foundation Schools which had been brought onto balance sheet in year and PFI related schools. These errors should have been identified through officers' reasonableness checks on valuation movements. **Recommendation** The Authority should ensure there is a check on the annual indices based uplifting process to ensure that it has been applied accurately and completely. This should include a reasonableness check over the larger movements.	To follow.

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Appendix 1: Key issues and recommendations (cont.)

No.	Priority	Issue and recommendation	Management response / responsible officer / due date
2	2	**Revaluation process of Property, Plant and Equipment (PPE)** For 136 of the 624 revalued assets, the reassessed asset life had not had been updated into the Authority's fixed asset register, resulting in a £1.2m impact on the Authority's calculated depreciation charge. **Recommendation** To help officers in reviewing and processing asset valuations the Authority should consider implementing the following changes: • Request a final electronic schedule of all final asset valuations, alongside the individual hardcopy valuation certificates that are currently provided. The schedule should include an asset number, reassessed asset life and revalued amount. • Review all valuations and reassessed asset lives to ensure they are reasonable. This should be done by calculating the movement on each revalued asset and focusing on those items with the larger asset movements. • Once revaluations have been processed into the fixed asset register, there should be a review process to ensure that all revaluations and asset lives have been updated correctly into the asset register.	To follow.
3	2	**Accounts Production Process** The accounts production process this year was carried out against a backdrop of implementing the new Agresso financial system which has placed significant additional pressure on the finance team. Some areas of the audit took longer to complete than originally planned and some of the additional information required from non-finance staff was difficult to obtain. Fully effective financial management and reporting arrangements have not been in place for the first half of 2015/16 and there have been difficulties in making accurate and complete payments to creditors and staff. These will require a higher than normal volume of in-year correcting entries in and the Authority needs to have effective arrangements for managing the clearance of the backlog of issues. **Recommendation** Finance staff should consider any lessons learned from this year's audit and the specific closedown processes and requirements of the Agresso system. Finance staff should hold early planning discussions with other staff engaged in the process and with external audit.	To follow.

Appendix 2: Audit differences

This appendix sets out the significant audit differences identified during the audit for the year ended 31 March 2015.

It is our understanding that all of these will be adjusted.

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

Corrected audit differences

The following table sets out the significant audit differences identified by our audit of the Authority's financial statements for the year ended 31 March 2015 that we wish to draw to your attention. It is our understanding that these will be adjusted in the final version of the financial statements approved by the Audit Committee.

	Impact			
No.	Income and Expenditure Statement	Assets	Reserves	Basis of audit difference
1		Cr PPE £57.823m	Dr Revaluation Reserve £57.823m	**Material Misstatement** The Authority engages its external valuer to review the carrying value at year-end of its material asset classes. The Authority has two material asset classes – school buildings and land. The valuer reviewed both of these for 2014/15 and determined that the carrying value of school buildings should be uplifted. The valuer provided the indices to be applied to these assets to the Authority. We reviewed the results of the uplifting exercise in applying the indices and found that of the 596 school building related assets which had been uplifted, 517 had been uplifted using the incorrect index. We also identified that foundation schools and PFI schools had been incorrectly omitted from the uplifting exercise.
2	Cr Gain or Loss on the disposal of non-current assets £7.628m		Dr Revaluation Reserve £7.628m	**Non-material Misstatement** A number of voluntary aided and voluntary controlled schools came off the Authority's balance sheet in 2014/15, in accordance with guidance issued by CIPFA for the year in LAAP Bulletin 101. Some of these schools had their carrying value uplifted using incorrect indices prior to disposal.
	Dr £7.628m	**Cr £57.823m**	**£65.451m**	**Total impact of adjustments**

Appendix 2: Audit differences (continued)

The cumulative impact of uncorrected audit difference is £1.269m.

A small number of disclosure amendments are to be made to the draft accounts.

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Uncorrected audit differences

The following table sets out the uncorrected audit differences identified by our audit of Lincolnshire County Council's financial statements for the year ended 31 March 2015.

No.	Impact		Basis of audit difference
	Income and Expenditure Statement	Assets	
1	Dr Depreciation £1.269m	Cr Property Plant and Equipment £1.269m	The Authority did not process the reassessed asset lives provided by the valuer for 136 assets, which in turn meant that the depreciation charge was understated for the year.
	Dr £1.269m	**Cr £1.269m**	**Total impact of uncorrected audit differences**

Other changes to the draft statements

A small number of amendments identified during our audit, focused on corrections or presentational improvements, are also to be made to the draft financial statements.

Appendix 3: Declaration of independence and objectivity

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

Requirements

Auditors appointed by Public Sector Audit Appointments Ltd 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 Public Sector Audit Appointments Ltd *Terms of Appointment* ('Public Sector Audit Appointments Ltd Guidance') and the requirements of APB Ethical Standard 1 *Integrity, Objectivity and Independence* ('Ethical Standards').

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

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

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

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

General procedures to safeguard independence and objectivity

KPMG'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 3: 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.

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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.

Disclosure of action concerning tax engagement

KPMG member firms and KPMG professionals are required to comply with independence standards that meet or exceed those set out in the IESBA Code of Ethics. In addition, the UK firm and our professionals are also required to comply with the requirements of the APB Ethical Standards. We also adhere to the Public Sector Audit Appointment's (PSAA) specific requirements regarding non-audit services.

These professional standards require that where the firm has determined that a breach of an audit independence standard has occurred, we discuss this and the actions we have taken or propose to take with you as soon as possible, communicate with you in writing all matters discussed and obtain your concurrence that action can be, or has been, taken to satisfactorily address the issue. This section of the report summarises two instances requiring action.

In March 2006 the Authority engaged KPMG to provide services to assist you with claims to recover excess UK tax credits on Foreign Income Dividends (claim also known as 'FID claim') and foreign dividends (claim also known as 'Manninen claim'). The total claim amount was £793,497 and success fee of 2% of any amounts recovered from HMRC was agreed.

In November 2009 the Authority engaged KPMG to provide services to assist you with claims to recover the withholding tax suffered on manufactured overseas dividends. Two claims had been filed by the Authority for a total of £1,369,803 and a success fee of 2% of any amounts recovered from HMRC was agreed.

Subsequently, in November 2012, KPMG LLP was appointed as auditor of the 2012/13 year of account and subsequent financial years. No work has been carried out in relation to these tax engagements in the period since KPMG LLP was appointed auditor.

Prior to 2010, the APB Ethical Standards did not prohibit such contingent fee arrangements, however in 2010 the standards were changed and paragraph 95 of APB Ethical Standard Number 5 now provides that an audit firm cannot provide services on a wholly or partly contingent basis where the outcome of those services is dependent upon the proposed application of tax law which is uncertain or has not been established. As the tax law applying to the subject matter of these engagements was and remains uncertain, following KPMG LLP's appointment as auditor the fee basis should have been revised to remove the contingent element in order to comply with this requirement. Action was therefore required to ensure compliance with the ethical standards..

This position was identified as our firm undertook a special exercise to ensure that any grandfathered tax contingent fee arrangements that were entered into with audit clients prior to the change in rules in 2010 had been correctly dealt with before 31 December 2014 which was the end of the grandfathering period provided for in the standard.

Appendix 3: 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.

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The arrangements for both of these engagements have now been revised to comply with the requirements of APB Ethical Standard Number 5, although after the 31 December 2014 deadline:

A revised fixed fee basis was agreed in December 2014 and subsequently a new variation letter was issued in April 2015 for the FID-Manninen work with any fee now based on a 'time spent' basis to be agreed in advance. Currently no fee has been agreed, nor is anticipated.

A new variation letter was issued in March 2015 for the MODs work on a fixed fee basis. The fee estimate for this work is £6,849.

We have considered this matter, and given the following factors we have determined this to be a less than significant breach of the APB Ethical Standards because:

- no amounts are recognised in the Council's or Pension Fund's accounts for the potential recovery of this tax;
- the amount of tax that is potentially recoverable (£2.1m plus interest) is, in any event, not material to the Council or Pension Fund;
- KPMG has not received any contingent fee income in respect of this engagement and has not performed any work in relation to this engagement since the date of appointment as auditor; and
- the potential contingent fee that KPMG could have received in respect of this engagement around £43,000 in total is not material to our firm.

Based on the above in our professional judgment we concluded that our objectivity has not been compromised and the firm and the engagement team are independent of the Council and the Pension Fund.

Auditor declaration

In relation to the audit of the financial statements of Lincolnshire County Council for the financial year ending 31 March 2015, we confirm that there were no relationships between KPMG LLP and Lincolnshire County Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Appendix 4: Materiality and reporting of audit differences

For 2014/15 our materiality is £19 million for the Authority's accounts.

We have reported all audit differences over £0.7 million for the Authority's accounts.

Materiality

The assessment of what is material is a matter of professional judgment and includes consideration of three aspects: materiality by value, nature and context.

- Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.
- Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.
- Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We used the same planning materiality reported in our External Audit Plan 2014/15, presented to you in March 2015.

Materiality for the Authority's accounts was set at £19m which equates to around 2 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any misstatements of lesser amounts to the extent that these are identified by our audit work.

Under ISA 260, we are obliged to report omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

ISA 450 requires us to request that uncorrected misstatements are corrected.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £0.7 m for the Authority.

Where management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit Committee to assist it in fulfilling its governance responsibilities.

Appendix 5: KPMG Audit Quality Framework

We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG.

The diagram summarises our approach and each level is expanded upon.

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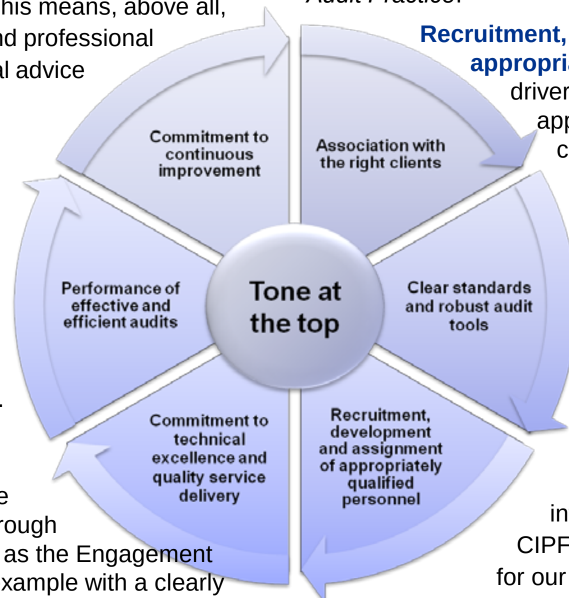
At KPMG we consider audit quality is not just about reaching the right opinion, but how we reach that opinion. KPMG views the outcome of a quality audit as the delivery of an appropriate and independent opinion in compliance with the auditing standards. It is about the processes, thought and integrity behind the audit report. This means, above all, being independent, compliant with our legal and professional requirements, and offering insight and impartial advice to you, our client.

KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG. We use our seven drivers of audit quality to articulate what audit quality means to KPMG.



We believe it is important to be transparent about the processes that sit behind a KPMG audit report, so you can have absolute confidence in us and in the quality of our audit.

Tone at the top: We make it clear that audit quality is part of our culture and values and therefore non-negotiable. Tone at the top is the umbrella that covers all the drives of quality through a focused and consistent voice. Tony Crawley as the Engagement Lead sets the tone on the audit and leads by example with a clearly articulated audit strategy and commits a significant proportion of his time throughout the audit directing and supporting the team.

Association with right clients: We undertake rigorous client and engagement acceptance and continuance procedures which are vital to the ability of KPMG to provide high-quality professional services to our clients.

Clear standards and robust audit tools: We expect our audit professionals to adhere to the clear standards we set and we provide a range of tools to support them in meeting these expectations. The global rollout of KPMG's eAudIT application has significantly enhanced existing audit functionality. eAudIT enables KPMG to deliver a highly technically enabled audit. All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's *Code of Audit Practice*.

Recruitment, development and assignment of appropriately qualified personnel: One of the key drivers of audit quality is assigning professionals appropriate to the Authority's risks. We take great care to assign the right people to the right clients based on a number of factors including their skill set, capacity and relevant experience.

We have a well developed technical infrastructure across the firm that puts us in a strong position to deal with any emerging issues. This includes:

- A national public sector technical director who has responsibility for co-ordinating our response to emerging accounting issues, influencing accounting bodies (such as CIPFA) as well as acting as a sounding board for our auditors.

- A national technical network of public sector audit professionals is established that meets on a monthly basis and is chaired by our national technical director.

- All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's *Code of Audit Practice*.

- A dedicated Department of Professional Practice comprised of over 100 staff that provide support to our audit teams and deliver our web-based quarterly technical training.

Appendix 5: KPMG Audit Quality Framework

We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

Quality must build on the foundations of well trained staff and a robust methodology.

Commitment to technical excellence and quality service delivery: Our professionals bring you up- the-minute and accurate technical solutions and together with our specialists are capable of solving complex audit issues and delivering valued insights.

Our audit team draws upon specialist resources including Forensic, Corporate Finance, Transaction Services, Advisory, Taxation, Actuarial and IT. We promote technical excellence and quality service delivery through training and accreditation, developing business understanding and sector knowledge, investment in technical support, development of specialist networks and effective consultation processes.

Performance of effective and efficient audits: We understand that how an audit is conducted is as important as the final result. Our drivers of audit quality maximise the performance of the engagement team during the conduct of every audit. We expect our people to demonstrate certain key behaviors in the performance of effective and efficient audits. The key behaviors that our auditors apply throughout the audit process to deliver effective and efficient audits are outlined below:

- timely Engagement Lead and manager involvement;
- critical assessment of audit evidence;
- exercise of professional judgment and professional scepticism;
- ongoing mentoring and on the job coaching, supervision and review;
- appropriately supported and documented conclusions;
- if relevant, appropriate involvement of the Engagement Quality Control reviewer (EQC review);
- clear reporting of significant findings;
- insightful, open and honest two-way communication with those charged with governance; and
- client confidentiality, information security and data privacy.

Commitment to continuous improvement: We employ a broad range of mechanisms to monitor our performance, respond to feedback and understand our opportunities for improvement.

Our quality review results

Public Sector Audit Appointments Ltd publishes information on the quality of work provided by us (and all other firms) for audits undertaken on behalf of them (http://www.psaa.co.uk/audit-quality/principal-audits/kpmg-audit-quality/).

The latest Annual Regulatory Compliance and Quality Report showed that we are meeting the overall audit quality and regulatory compliance requirements.

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