KPMG

External audit report 2016/17

Lincolnshire County Council and Lincolnshire Pension Fund

September 2017

Summary for Audit Committee

Financial statements

This document summarises the key findings in relation to our 2016-17 external audit at Lincolnshire County Council ('the Authority').

This report focusses on our on-site work which was completed in July and August 2017 on the Authority and the Pension Fund's significant risk areas, as well as other areas of your financial statements. Our findings are summarised in Section One.

There are currently the following outstanding matters:

- Final audit Director review;
- Addressing any remaining audit queries and any matters arising from our completion procedures;
- General audit file completion and review procedures;
- Post balance sheet events review up to the date of signing the audit opinion; and
- Final review of the working papers and amended accounts.

Subject to all outstanding queries being resolved to our satisfaction we anticipate issuing an unqualified audit opinion on the Authority's financial statements before the deadline of 30 September.

We also anticipate issuing an unqualified audit opinion in relation to the Pension Fund's financial statements by 30 September 2017.

Based on our work, we have raised 7 recommendations. Details on our recommendations can be found in Appendix 1.

We are now in the completion stage of the audit and anticipate issuing our completion certificate by 30 September 2017.

Use of resources

We have completed our risk-based work to consider whether in all significant respects the Authority has proper arrangements to ensure it has taken properly informed decisions, worked with partners and third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

We therefore anticipate issuing an unqualified value for money conclusion.

See Section Two for further details.

Whole of Government Accounts

This work is in progress and we expect to issue our report at the same time as we issue our audit opinion on the Authority's accounts.

Public Interest Report

We have a duty to consider whether to issue a report in the public interest about something we believe the Authority should consider, or if the public should know about. We have nothing to report.

Acknowledgements

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

We ask the Audit Committee to note this report.

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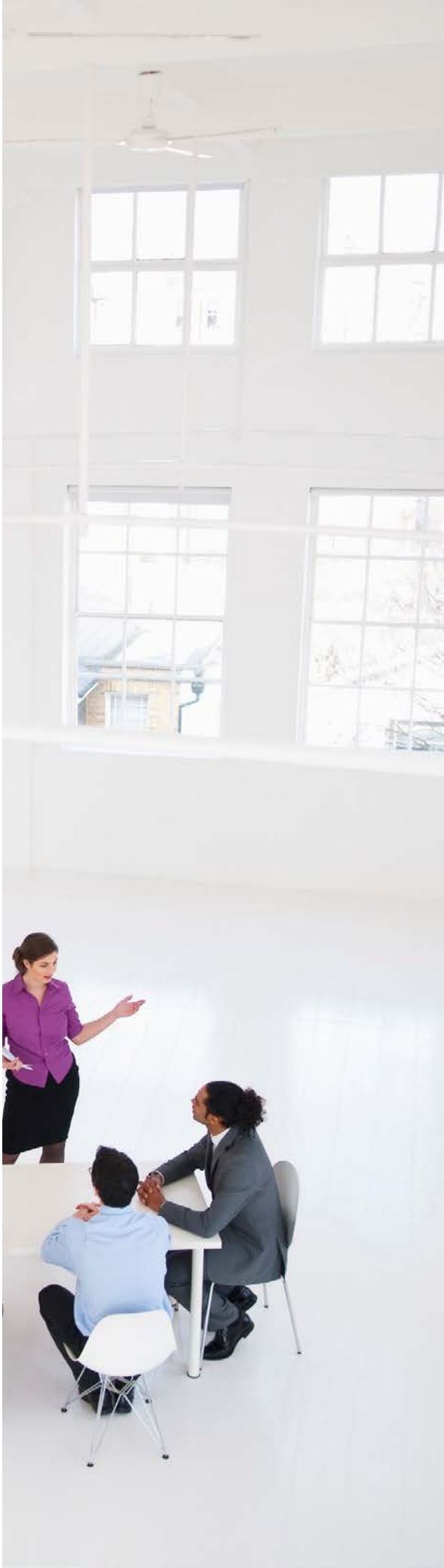
Section one

Financial Statements

We anticipate issuing an unqualified audit opinion on the Authority's 2016/17 financial statements and the Lincolnshire Pension Fund by 30 September 2017. We will also report that your Annual Governance Statement complies with the guidance issued by CIPFA/SOLACE (*'Delivering Good Governance in Local Government'*) published in April 2016.



Significant audit risks

Our *External Audit Plan 2016/17* sets out our assessment of the Authority and the Pension Fund's significant audit risks. We have completed our testing in these areas and set out our evaluation following our work:

Significant audit risks	Work performed
1. Significant changes in the pension liability due to LGPS Triennial Valuation (Authority and Pension Fund)	**Why is this a risk?** During the year, the Pension Fund has undergone a triennial valuation with an effective date of 31 March 2016 in line with the *Local Government Pension Scheme (Administration) Regulations 2013*. The share of pensions assets and liabilities for each admitted body is determined in detail, and a large volume of data is provided to the actuary to support this triennial valuation. There is a risk that the data provided to the actuary for the valuation exercise is inaccurate and that these inaccuracies affect the actuarial figures in the accounts. The Pension Fund only includes limited disclosures around pensions liabilities but we anticipated that this would be identified as a risk area by some of the admitted bodies, whose pension liabilities represent a significant element of their balance sheet. This included the Authority itself. **Our work to address this risk** As part of our audit of the Pension Fund, we undertook work on a test basis to agree the data provided to the actuary back to the systems and reports from which it was derived and to understand the controls in place to ensure the accuracy of this data. We engaged specialists from our KPMG pensions team to assess the actuary's approach and the reasonableness of the assumptions used in determining the pensions estimates.. We were also required, under the protocols put in place by the PSAA for this purpose, to respond to specific requests from the auditors of other admitted bodies. There are no significant matters from our work which we need to draw to your attention.
2. Agresso	**Why is this a risk?** The Authority experienced significant difficulties during 2015-16 with the operation of the newly introduced Agresso system. In our 2015-16 ISA260 report we assessed the Authority's control environment and concluded that not all the weaknesses in the system controls and financial reporting arrangements had been fully addressed. We regarded the continuing weaknesses in the system controls and financial reporting arrangements as a significant audit risk for this year's Authority and Pension Fund financial statements. **Our work to address this risk** We liaised with Internal Audit and the finance team to assess the progress the Authority had made in strengthening the Agresso system controls and carried our own testing. We found a general improvement, compared to last year, in the framework of controls in place and in the arrangements for financial monitoring and reporting. Payroll system controls continue to be a area of concern and our audit approach to this to was again largely substantive. We have also substantively tested the main payments and cash reconciliation items.

Significant audit risks

Significant audit risks	Work performed
3. Year end processes and schools consolidation	**Why is this a risk?** The difficulties encountered with Agresso in 2015-16 impacted on the completeness and timing of some of the important year-end accounts closure processes: - the year-end schools consolidation was delayed and the draft accounts were published before it was completed. Changes were required to the published final statements to reflect the outcome of the process. - alongside that, there were a larger than normal number of non-material uncleared or unprocessed items. The year-end bank reconciliations included a number of non-material reconciling items which need to be cleared during 2016-17. It was important that the 2016-17 closure programme and timetable addressed these difficulties and that the prior year unprocessed items were cleared. **Our work to address this risk** We liaised with the finance team regarding the closedown plans and arrangements for addressing the difficulties encountered in 2015-16. We confirmed the key dates and information requirements. We reviewed the steps taken to clear the 2015-16 non-material uncleared and unreconcilied balances and tested the current year-end reconciliations. There are no significant matters from our work which we need to draw to your attention.

Considerations required by professional standards

Fraud risk of revenue recognition

Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.

In our *External Audit Plan 2016/17* 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.

Management override of controls

Professional standards require us to communicate the fraud risk from management override of controls as significant because management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

Our audit methodology incorporates the risk of management override as a default significant risk. We have not identified any specific additional risks of management override relating to this audit.

In line with our methodology, we carried out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.

There are no matters arising from this work that we need to bring to your attention.

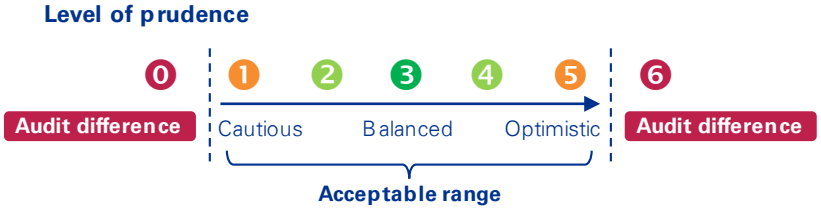
Other areas of audit focus

We identified four areas of audit focus. These are not considered as significant risks as there are less likely to give rise to a material error. Nonetheless these are areas of importance where we would carry out substantive audit procedures to ensure that there is no risk of material misstatement.

Other areas of audit focus	Our work to address the areas
1. Disclosures associated with retrospective restatement of CIES, EFA and MiRS	**Background** CIPFA has introduced changes to the 2016-17 Local Government Accounting Code (Code): — Allowing local authorities to report on the same basis as they are organised by removing the requirement for the Service Reporting Code of Practice (SeRCOP) to be applied to the Comprehensive Income and Expenditure Statement (CIES); and — Introducing an Expenditure and Funding Analysis (EFA) which provides a direct reconciliation between the way local authorities are funded and prepare their budget and the CIES. This analysis is supported by a streamlined Movement in Reserves Statement (MiRS) and replaces the current segmental reporting note. The Authority was required to make a retrospective restatement of its CIES (cost of services) and the MiRS. New disclosure requirements and restatement of accounts require compliance with relevant guidance and correct application of applicable accounting standards. **What we have done** For the restatement, we have obtained an understanding of the methodology used to prepare the revised statements. We have also ensured compliance with new disclosure requirements and found no issues to note.
2. Pension Fund	**Background** In our Audit Plan we identified the following matters which were relevant to our 2016-17 Pension Fund audit: • 2016 CIPFA Code on Local Authority Accounting – the guidance included a small number changes to the expected fair value disclosures, and other changes to the analysis of investment management expenses and a disclosure note covering remuneration of key management personnel. We planned to discuss the new requirements with the Pension Fund team and agree the new disclosures, including any restatement of the prior year comparators. • Pension Fund administrator arrangements - The changes to the arrangements introduced in 2015-16 had become more established during 2016-17 although the provider was not yet consistently meeting all the required performance standards. We planned to discuss the Provider's performance with the Pension Fund team and confirm the information required for the audit. • Changes to the Pension Fund Manager arrangements - During 2016-17 there were several changes to the fund managers in operation, including an external fund manager taking over responsibility for managing the internally managed portfolio (c.£350m). We planned to review the steps taken to effectively manage these changes and confirm the arrangements for obtaining appropriate year-end valuations and relevant Service Auditor Reports on the fund managers' controls. **What we have done** We have carried out the planned procedures described above and there are no issues that we need to bring to your attention in this report.

Judgements

We have considered the level of prudence within key judgements in your 2016-17 financial statements and accounting estimates. We have set out our view below across the following range of judgements.



Subjective areas	2016-17	2015-16	Commentary
Property, Plant and Equipment (PPE) valuations (Authority)	3	3	Valuations are consistent with information provided by the Authority's external valuer. We have reviewed the arrangements and discussed the approach with managers. The Authority has not made any significant changes to its approach to asset lives or its valuation arrangements. We have used our own valuation expert to advise on the reasonableness of the Authority's approach to determining land values as there was an unanticipated significant fall in the value of the estimate this year. The Authority's valuer has been able to provide our expert with sufficient evidence and explanation to help us decide that the estimate was not materially misstated.
Pensions liability (Authority)	3	3	There have been no significant changes in the approaches to determining the estimate. The Authority has again relied on an independent expert actuarial valuation for its estimates. We used our own actuarial expert in the course of our work and did not identify any concerns regarding the Authority's approach or the assumptions used. The reported balance, together with assumptions and disclosures for inflation, discount rate, salary growth, life expectancy etc. are consistent with the report from the external actuary.
Provisions (Authority)	3	3	We have reviewed the Authority's approach to estimating its provisions and not identified any material misstatement or further issues of concern for the Authority's attention.
Investments (Authority and Pension Fund)	3	3	We have reviewed arrangements for determining the accurate values for the Authority and Fund's investments and financial instrument disclosures. We did not identify any concerns regarding the valuations recorded.
Disclosure of Retirement Benefit Plans (Pension Fund)	3	3	IAS 26 requires the present value of the Fund's promised retirement benefits to be disclosed (the liability is not included within the Net Assets Statement). There have been no significant changes in the approaches to determining the estimate. The Authority has again relied on an independent expert actuarial valuation for its estimates. We did not identify any concerns regarding the Authority's approach or the assumptions used.

Proposed opinion and audit differences - Authority Accounts

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's 2016/17 financial statements following approval of the Statement of Accounts by the Audit Committee on 25 September 2017.

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 3 for more information on materiality) level for this year's audit was set at £12 million. Audit differences below £0.6 million are not considered significant.

We did not identify any material misstatements. We identified a small number of presentational issues that have been adjusted by management.

Annual governance statement

We have reviewed the Authority's final 2016-17 Annual Governance Statement and confirmed 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.

Narrative report

We have reviewed the Authority's final 2016-17 narrative report and have confirmed that it is consistent with the financial statements and our understanding of the Authority.

Whole of Government Accounts

This work is in progress and we anticipate issuing our audit report at the same time as we give the opinion on the Authority's accounts.

Proposed opinion and audit differences – Pension Fund Accounts

We anticipate issuing an unqualified audit opinion on the Fund's 2016/17 financial statements following approval of the financial statements by the Audit Committee on 25 September 2017. We anticipate issuing an unqualified opinion on the Pension Fund Annual Report at the same time as our opinion on the Statement of Accounts.

Pension fund audit

Our audit of the Fund also did not identify any material misstatements. There are no other audit differences that we need to report to you.

We identified a small number of presentational corrections or adjustments required to ensure that the accounts are compliant with the Code. We understand that management will be addressing these where significant.

Annual report

We have reviewed the draft Pension Fund Annual Report and confirmed that:

- It complies with the requirements of the Local Government Pension Scheme (Administration) Regulations 2008; and
- The financial and non-financial information it contains is not inconsistent with the financial information contained in the audited financial statements.

We anticipate issuing an unqualified opinion on the Pension Fund Annual Report at the same time as our opinion on the Statement of Accounts.

Accounts production and audit process

Our audit standards (*ISA 260*) require us to communicate our views on the significant qualitative aspects of the Authority's accounting practices and financial reporting.

We also assessed the Authority's process for preparing the accounts and its support for an efficient audit. The efficient production of the financial statements and good-quality working papers are critical to meeting the tighter deadlines.

Accounting practices and financial reporting

We consider the Authority's accounting practices to be appropriate.

In our 2015/16 ISA260 report we referred to the difficulties the Authority had experienced with operating Agresso during the year and the impact on the year-end accounts and our audit. The Authority has been working with Serco throughout the year to improve controls and the year-end accounts production was much improved.

The Accounts and Audit Regulations 2015 introduces a statutory requirement to produce a draft set of financial statements much earlier for the year 2017-18. It also shortens the time available for the audit. The finance team is aware of the earlier 31 May 2018 deadline for 2017-18. The improvements made in the current year means the Authority is in a relatively good position to meet the new 2017-18 deadline but it needs to continue to ensure its arrangements are effective.

Completeness of draft accounts

We received a complete set of draft accounts on 30 June 2017, which is the statutory deadline.

Quality of supporting working papers

Earlier in the year we issued our *Accounts Audit Protocol 2016/17* ("Prepared by Client" request) in which outlines our documentation request. This helps the Authority and the Fund to provide audit evidence in line with our expectations.

Virtually all of the required working papers were available by the agreed date and met the expected quality standards. There were some specific weaknesses in the working papers to support the staff cost notes in the accounts. Changes were required to both the working papers and these notes. We have raised a recommendation in respect of working papers and closedown arrangements at Appendix 1.

Response to audit queries

The finance team responded promptly during the audit to our requests for additional information or explanation.

Pension Fund audit

The audit of the Fund was completed alongside the Authority's audit. There are no specific matters to bring to your attention relating to this. The quality of the working papers was good and officers were helpful and responsive during the audit.

KPMG Specialists

We have engaged specialist KPMG staff to support our audit in response to matters identified in the following areas:

- Plant, Property and Equipment Valuations – We have used our own valuation expert to advise on the reasonableness of the Authority's approach to determining land values as there was an unanticipated significant fall in the value of the estimate this year.
- Pensions Estimates - We engaged specialists from our KPMG pensions team to assess the your actuary's approach and the reasonableness of the assumptions used in determining your pensions estimates.
- IT Controls – our IT specialists undertook testing of the Agresso IT General Controls as part of our audit approach.

The only findings from their work that we need to bring to your attention in this report are in relation to the Agresso IT General Controls. More information is included on these matters below and at Appendix 1.

Controls over key financial systems

We have tested opinion controls as part of our focus on significant audit risks and other parts of your key financial systems on which we rely as part of our audit. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

We found a general improvement, compared to last year, in the framework of controls in place and in the arrangements for financial monitoring and reporting. Payroll system controls continue to be a area of concern and our audit approach to this was again largely substantive.

Further details on the issues we need to raise in relation to payroll and associated recommendations can be found in Appendix 1. There is overlap between these recommendations and the much broader set of recommendations raised in Internal Audit's reports to the Audit Committee.

Agresso IT General Controls

We undertook testing of IT General Controls as a precursor for future reliance upon IT systems as part of our audit approach. We carried out a range of procedures to assess controls around the authority's finance system in respect of access to programs and data and program change control.

Whilst undertaking these procedures, the authority was unable to provide us with adequate evidence to demonstrate that adequate controls were in place across each of these control areas. In particular, we noted that governance processes and the definition of responsibilities between the authority and their supplier had yet to fully mature as the operation of the system moved from implementation project to business as usual.

Further detail and associated recommendations can be found in Appendix 1.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's 2016-17 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 and Lincolnshire Pension Fund for the year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and Lincolnshire County Council and Lincolnshire Pension Fund, 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.

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 management for presentation to the Audit Committee. 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, non disclosure, related party, public interest reporting, questions/objections, opening balances).

There are no others matters which we wish to draw to your attention in addition to those highlighted elsewhere in this report.

Section two

Value for money

Our 2016-17 VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions, worked with partners and third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We have concluded that the Authority has made proper arrangements to ensure it took properly-informed decisions, worked with partners and third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

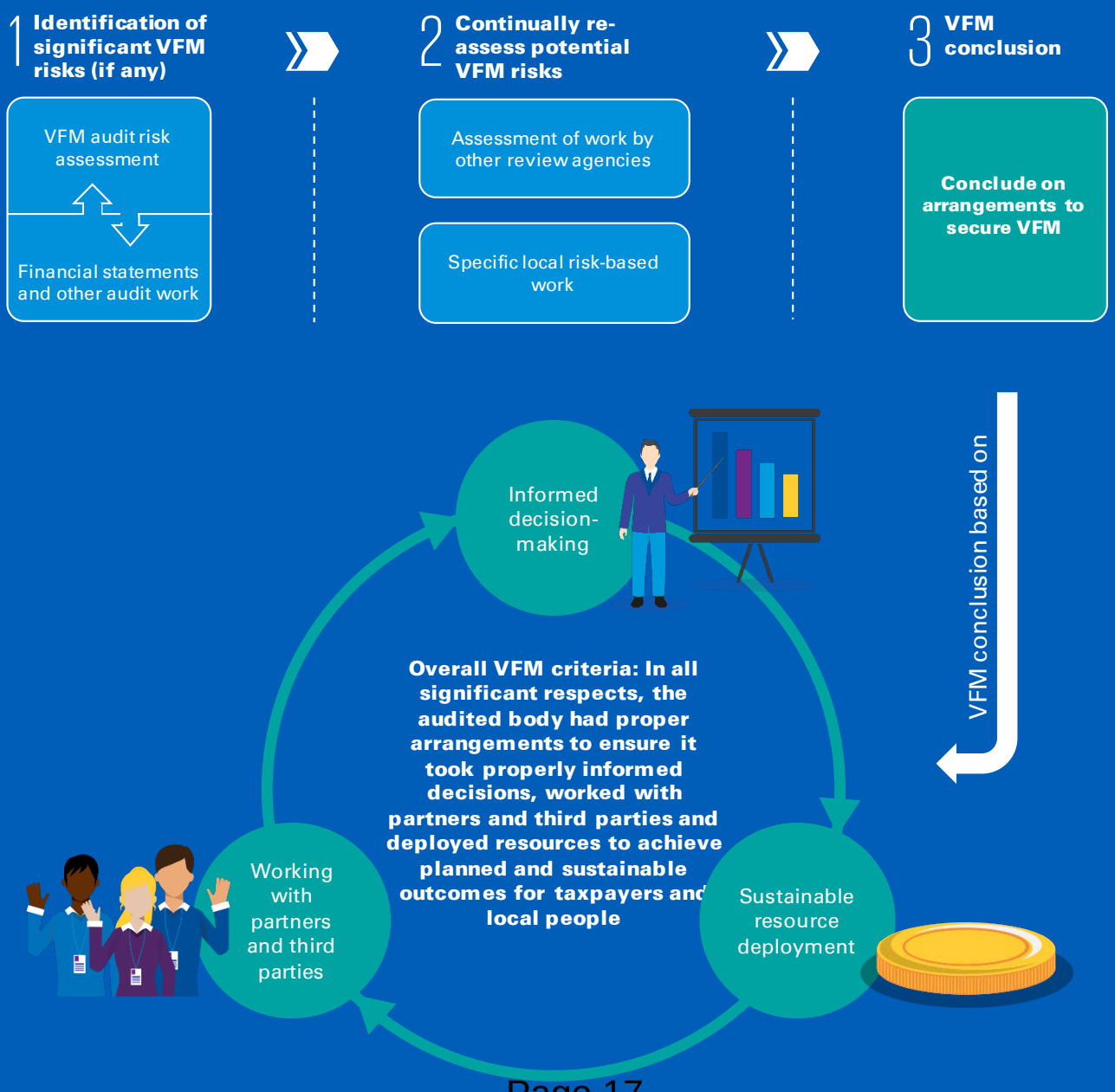
VFM conclusion

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to cause the auditor to reach an inappropriate conclusion on the audited body's arrangements.'

Our VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions, worked with partners and third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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



The table below summarises our assessment of the significant VFM risk and area of focus identified against the three sub-criteria. This directly feeds into the overall VFM criteria and our value for money opinion.

VFM assessment summary

VFM risk	Informed decision-making	Sustainable resource deployment	Working with partners and third parties
Significant VFM Risk			
1. Financial management and monitoring arrangements, and the Corporate Support Services Provider's performance	✓	✓	✓
Area of focus			
2. Financial standing and medium term financial planning	✓	✓	✓
Overall summary	✓	✓	✓

In consideration of the above, we have concluded that in 2016/17, the Authority has made proper arrangements to ensure it took properly-informed decisions, worked with partners and third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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

Significant VFM risks

We identified one significant VFM risk and one area of audit focus, as communicated to you in our *2016/17 External Audit Plan*. In both cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

VFM risk areas	Work performed
Significant VFM Risk	**Why is this a risk?**
Financial management and monitoring arrangements, and the Corporate Support Services Provider's performance	The problems with Agresso and the operation of the Corporate Support Services contract in 2015-16 meant that the Authority did not have effective financial management and monitoring arrangements, and recovery measures were expected to continue to operate well into 2016-17. We qualified the 2015-16 VFM conclusion, on the basis that the difficulties encountered in the year represented significant weaknesses in the Authority's arrangements for informed decision making and working with third parties. These issues have continued to represent risks in relation to the relevant sub-criteria of the VFM conclusion and we will assess the actions taken by the Authority to address these weaknesses in its arrangements. **Summary of our work** We have, amongst other things, considered: • the key arrangements the Council had in place during 2016-17 and to date for managing this support services contract - there are wide-ranging formal arrangements in place. • the Contractor's reported performance and the Authority's arrangements for scrutiny and challenge – the Authority has agreed a new framework and is regularly monitoring performance and, if necessary, claiming service credits. • the specific steps the Authority has taken in response to the independent 'lessons learned' report which was issued November 2017 – the Authority has, for example, commissioned independent assurance regarding the 2017-18 upgrade to Agresso. • the budget monitoring and setting arrangements established for 2016-17 and the reliability of the information reported – these arrangements are reasonable and proportionate and no significant issues have been reported during the year regarding their operation. • our interim and final accounts audit findings – there are no matters which significantly adversely impact on our VFM conclusion. • the Authority's reported financial outturn for 2016-17 – there are no matters in the outturn report which indicate significant weaknesses in the Authority's arrangements. **Conclusion** There are continuing concerns regarding the Contractor's performance, which is still not consistently meeting minimum service levels in all areas, and the governance arrangements are relatively resource intensive and include focus on key areas of difficulty (most significantly relating to HR/Payroll and IT services). We are satisfied however that the factors which lead to the qualified 2015-16 VFM conclusion have been sufficiently addressed to allow us to give an unqualified conclusion for 2016-17.

VFM risk areas	Work performed
Area of focus **Financial standing and medium term financial planning**	**Why is this a risk?** The Authority continues to face similar financial pressures and uncertainties to those experienced by others in the local government sector. The Authority has continued to only publish a one year budget, with 2017-18 being the latest. The Authority needs to have effective arrangements in place for managing its annual budget, generating income and identifying and implementing any savings required to balance its medium term financial plan. This is relevant to the sustainable resource deployment sub-criteria of the VFM conclusion. **Summary of our work** We have considered: ***2017-18 budget*** In February 2017, the Authority approved a balanced 2017-18 budget. The budget included the required S.151 Officer assurances relating to the robustness of the budget and the adequacy of the level of reserves, but acknowledged the risks around the delivery and timing of savings initiatives and the need to address the medium term budget shortfall from 2018-19 onwards. The budget reflects a mixed approach to addressing the cost pressures identified (£26.4m) and reduced level of central funding (£27.7m reduction in general government grants). The Authority approved: • a 3.95% increase in Council Tax, including 2% for the 'social care precept'; • savings plans of £39.5m; and • A £17.9m transfer from the earmarked Financial Volatility Reserve. General Reserves were budgeted to continue to meet the risk assessed level of 3.5% of the total revenue budget. The budget also reflects £8m funding support for service transformation through the Flexible Use of Capital Receipts Strategy and an additional £11.6m from continuing savings in capital charges following the review of the MRP policy and the rephrasing of the capital programme. The 2017-18 position improved in May 2017 when the Authority amended the budget to reflect £15.2m Supplementary Improved Better Care Funding which was awarded after the budget had been approved. The additional funding has been allocated to a range of adult social care services in 2017-18 with £11.8m to be spent through the Adult Frailty, Long Term Conditions and Physical Disability commissioning strategy. ***Medium term financial planning*** The Authority has during 2017-18 been developing further its options for securing medium term financial sustainability. The overall financial planning framework reflects the Government's four year funding settlement with the Council. Under this multi year settlement the level of general government grants was expected to fall from £60.8m in 2017-18 to £28.1m in 2019-20. Managers have also been confirming their assessment of the expected cost pressures due to demographic changes and other factors. We have considered the relevant Corporate Management Board and Informal Executive reports from the early part of 2017-18 which demonstrate the progress being made, with the proposals due to inform the autumn 2017 2018-19 budget setting process. The emerging framework indicates a way forward for the Authority to balance 2018-20 budgets which includes a combination of use of reserves and additional savings. Management is working up proposals for these savings and is to report to members later in the year. **Conclusion** At this stage, in the context of the uncertainties and risks faced by the Authority, there are no significant concerns regarding the Council's medium term financial standing which indicate that at this stage an unqualified VFM conclusion cannot be given. The Authority clearly though needs to continue to closely monitor progress in all these areas.

Appendices

Appendix 1

Key issues and recommendations

Our audit work on the Authority's 2016-17 financial statements has identified a number of issues. We have listed these issues in this appendix together with our recommendations.

The Authority should closely monitor progress in addressing the risks, including the implementation of our recommendations. We will formally follow up these recommendations next year.

Each issue and recommendation have been given a priority rating, which is explained below.

High priority — 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.

Medium priority — 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.

Low priority — Issues that would, if corrected, improve internal control in general but are not vital to the overall system. These are generally issues of good practice that we feel would benefit if introduced.

The following is a summary of the issues and recommendations raised in the year 2016/17.

Priority	Total raised for 2016/17
High	**1**
Medium	**5**
Low	**1**
Total	**7**

Accounts Production – Recommendations

Medium priority

Working papers

Virtually all of the required working papers were available by the agreed date and met the expected quality standards. There were some specific weaknesses in the working papers to support the staff cost notes in the accounts. Changes were required to both the working papers and these notes during the audit.

Recommendation

We recommend that the Authority ensure there are effective quality assurance arrangements in place for the production of the 2017-18 supporting working papers.

Management Response

The Finance team had already identified various issues relating to this and external audit's other observations.

Early training of Finance team is already planned in order to highlight and address the issues we have encountered in 2016-17. One of the planned training sessions will address the issue relating to the working papers and preparation of notes. There are various points that a preparer has to be aware in order to satisfy the requirements of the auditors and this will be communicated to the team to improve further the quality of the notes.

Included in the planned work within Finance, we are currently looking at the various payroll reports we have used to prepare the notes to the accounts to identify the required changes in order to produce the notes. We are also putting in place a more robust process in reviewing the work when producing these notes.

Further audit requirements by the auditors from Serco will continue to be managed through their Business Relationship Manager as we have found this to be effective.

Medium priority

Production of 2017-18 draft accounts and external audit

The draft financial statements were prepared and published by 30 June 2017. The Authority is in a relatively good position to meet the 31 May 2018 deadline for the publication of the 2017-18 draft financial statements. Nevertheless it needs to continue to ensure its arrangements are effective. The audit opinion deadline has also been brought forward to 31 July 2018 meaning that there will be much less time for the accountancy team to respond to and process any audit queries or changes to the draft financial statements. There was a relatively small number of audit queries this year and presentational errors in the 2016-17 draft financial statements identified during our audit, and these are to be corrected by management.

Recommendation

The accountancy team should critically review its closedown arrangements and the format and likely content of the Statement of Accounts before the 2017/18 year-end and discuss its proposals with KPMG before the statements are produced.

Management response

We are now working on the closedown timetable in order to meet the early deadline. Early training of the Finance team to highlight and address the issues we have encountered in 2016-17 is already planned. Additionally, training is also being planned for budget holders to engage them and be aware of their role in the closedown process.

Accounts Production – Recommendations

Low priority

School cash balances

Included within the total Cash and Cash Equivalents balance in hand is around £2.5m relating to the 2014-15 year-end balances for three prime account schools which have since converted to academy status. There are corresponding creditor balances in the accounts which off-set this balance. The relative amounts due to and from these schools are under dispute and there have been difficulties and delays in the Authority and the schools determining an agreed position.

Recommendation

We recommend the Authority progress this matter during 2017-18 and ahead of the year-end accounts.

Management response

The balance sheet review process will be strengthened this year. This will pick up any outstanding issues that will need resolving, like the School cash balances.

We will continue to work with the auditors on any changes we will be making for the contents of the Statement of Account for 2017-18

Agresso IT General Controls - Recommendations

Medium priority

User Administration

We inspected documentation describing the existence of user administration processes; however the authority was unable to provide evidence to support the appropriateness of access provided to a sample of new starters. Furthermore, we identified a number of active user accounts associated with staff who had left the authority. Upon further investigation, it was established that there were weaknesses in the leavers' process due to reliance upon line manager notification and the absence of complimentary detective controls.

Recommendation

We recommend that the authority maintains a searchable record of user access requests in order to support accountability and provide an audit trail for statutory audit purposes. Furthermore, the authority should make improvements to the leavers' process to reduce reliance upon line manager notification as the primary control point and to eliminate the possibility of account re-use after an employee has left.

Management Response

Agreed.

From an IT perspective: The control of access to software systems and the management of Active Directory accounts is undertaken by the Council's IT Service Provider, Serco. There are technical controls which meet ISO27001 and PSN Co-Co obligations in place and Serco have processes and procedures to meet these obligations. All user access requests are managed via the IT Provider's IT Service Desk tool, Remedy On Demand (RoD) and therefore a log of all requests for audit purposes is available for audit purposes.

At the point that the Serco IT Team are made aware of a Leaver, the process works well. However, the processes employed by the Serco HR Admin Team were historically poor and this has caused some issues. The data within Agresso, which should act as the trusted source for staff information is inaccurate and this has led to inaccuracies in the corresponding IT systems. A number of initiatives have been instigated to reduce this impact including a complete review of the starters, leavers and movers process across both HR and IT; unfortunately, these initiatives stalled.

To mitigate these risks the Council has invested in Microsoft Identity Manager to streamline and workflow the changes in the HR system to system access, however this project is currently running in excess of two and a half years late due to delivery issues within Serco.

From an Agresso System Administration perspective: The internal reporting for Agresso (LAGAN) requires further development to provide the information required for the Leavers process. This will be raised with the People Management Portfolio Board, however it is hoped that the current MIM project will address some of these weaknesses.

However, the Council has a deliberate policy of not closing users on Agresso when people leave the Authority. This is because there may well be transactions in the system part-way through workflow, which need to be actioned by a nominated substitute. If the user record is closed, these transactions cannot be completed. Because access to the system is by single sign-on through the person's network logon, the risk of unauthorised access is very low, subject to the efficient working of the Leavers process (see comments and actions above).

Agresso IT General Controls - Recommendations

Medium priority

Change Management

We inspected documentation describing the existence of a change management process based upon ITIL principles; however, despite multiple requests to the authority and its supplier, we were not provided with any evidence to support the effective implementation or operation of this process.

Recommendation

The authority should maintain adequate records to demonstrate the effective operation of their change management processes in order to provide accountability for actions undertaken. This will support effective operational processes and the ability to roll-back in the event of a failed change, as well as providing an audit trail for statutory audit purposes.

Management Response

Agreed.

From an IT perspective: The IMT team manages the Change Advisory Board (CAB) process which protects the infrastructure and systems from ungoverned technical change; this is aligned with ITIL. Changes which are only impacting a single system is governed by the Governance Procedures within that user-group and would not be subject to CAB.

From an Agresso System Administration perspective (for those changes which are not approved via CAB): This will be raised with the Agresso Governance Board (where all none CAB approvals are made), and more formal processes established for agreeing these changes.

Medium priority

Segregation of Duties

We established that there is no segregation of duties between development staff and those responsible for migration of changes into to the live environment. Whilst an informal system of management checks / peer review is used to check that actual changes to the live system has been carried out according to the approved configuration document, this check is not documented or evidenced. We were unable to establish any relevant monitoring or compensating controls to mitigate the associated risks and further noted that formal definition of appropriate access to change and development staff (including respective responsibilities of the authority and their supplier) is still under development.

Recommendation

We recommend that, where practical, access to undertake development and migrate changes to the live environment should be assigned to separate roles. Roles and responsibilities for the management of the live system, including the respective responsibilities between the authority and their supplier, should be agreed and documented.

Management Response

Agreed. In terms of the comments on documentation this will be raised with the Agresso Governance Board, and more formal processes established for agreeing changes. Due to the size of the team it is feasible to have a division of duties between development of changes and application in the live environment. However, there is a process of peer review where work is developed and reviewed by different team members. There is also an established process of developing, building and testing before changes are migrated into the live environment to reduce the risk of manual error.

Agresso Controls - Recommendations

High priority

Payroll Control Weaknesses

We have tested key opinion controls as part of our focus on significant audit risks and other parts of your key financial systems on which we rely as part of our audit. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

Payroll system controls continue to be a area of concern our audit approach to this was again largely substantive. There is overlap between these recommendations and the much broader set of recommendations raised in Internal Audit's reports to the Audit Committee. The areas of weakness identified during our testing included:

- Payroll Exception Reporting – there have been no consistent and robust control throughout the year. The arrangements were unclear and the exception reports have been inconsistently run, saved and annotated.

- Starters and leavers - from the testing carried out we identified a number of control deficiencies These included weaknesses in evidence to support authorisation of new starters or processing of leavers, and a number of employees' Agresso Accounts still being 'active' despite having left the organisation (a result of Payroll not properly terminating the employee on the Agresso System).

The continuing weaknesses in the Payroll system controls are an area of concern and our audit approach to this was again largely substantive.

Recommendation

The Audit Committee should continue to monitor the provider's progress in improving its payroll controls and addressing Internal Audit's recommendations.

Appendix 2

Audit differences

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which in your case is the Audit 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.

Our audit did not identify any material misstatements in our audit of the Authority or Pension Fund accounts. There were a number of presentational matters and notes to the accounts which officers agreed to amend. These included:

Note 35 – Officers Remuneration

Note 36 – Termination Benefits

Note 37 – External Audit Costs

We will check these expected amendments have been made to the final statement of accounts before giving our audit opinion.

Materiality and reporting of audit differences

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

Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.

Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.

Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We used the same planning materiality reported in our External Audit Plan 2016/17, presented to you in March 2017.

Materiality for the Authority's accounts was set at £12 million which equates to around 1% 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 £0.6 million 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.

Materiality – Pension fund audit

The same principles apply in setting materiality for the Pension Fund audit. Materiality for the Pension Fund was set at £19 million which is approximately 1% of gross assets.

We design our procedures to detect errors at a lower level of precision, set at £0.9 million for 2016/17

Appendix 4

Declaration of independence and objectivity

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice (the 'Code') which states that:

> *"The auditor should carry out their work with integrity, objectivity and independence, and in accordance with the ethical framework applicable to auditors, including the ethical standards for auditors set by the Financial Reporting Council, and any additional requirements set out by the auditor's recognised supervisory body, or any other body charged with oversight of the auditor's independence. The auditor should be, and should be seen to be, impartial and independent. Accordingly, the auditor should not carry out any other work for an audited body if that work would impair their independence in carrying out any of their statutory duties, or might reasonably be perceived as doing so."*

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 LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Partners and staff annually confirm their compliance with our Ethics and Independence Manual including in particular that they have no prohibited shareholdings.

Our Ethics and Independence Manual is fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through: Instilling professional values, Communications, Internal accountability, Risk management and Independent reviews.

We would be happy to discuss any of these aspects of our procedures in more detail.

Auditor declaration

In relation to the audit of the financial statements of Lincolnshire County Council and Lincolnshire Pension Fund for the financial year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and Lincolnshire County Council and Lincolnshire Pension Fund, 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.

Non-audit work and independence

Below we have listed the non-audit work performed and set out how we have considered and mitigated (where necessary) potential threats to our independence.

Summary of non-audit work		
Description of non-audit service	**Estimated fee**	**Potential threat to auditor independence and associated safeguards in place**
Review of Agresso ERP project management	£50,000	**Self-interest**: This engagement is entirely separate from the audit through a separate contract, engagement team and lead partner. The fee was set separately. Therefore, the proposed engagement will have no perceived or actual impact on the audit team and the audit team resources that were deployed to perform a robust and thorough audit. **Self-review:** The did not impact on our opinion and we do not consider that the outcome of this work will be a threat to our role as external auditors. The existence of a separate team for this work is a further safeguard. Consequently, we consider we have appropriately managed this threat. **Management threat:** This work will be advice and support only – all decisions will be made by the Authority. **Familiarity**: This threat is limited given the scale, nature and timing of the work. The existence of the separate team for this work is the key safeguard. **Advocacy**: We did not act as advocates for the Authority in any aspect of this work. The scope of this work falls well short of any advocacy role. **Intimidation**: not applicable
Teachers' Pensions Agency Return 2015/16	£3,000	**Self-interest**: This engagement is entirely separate from the audit and there is a separate engagement letter in place. **Self-review:** The nature of this work is to issue the Accountant's Independent Assurance Report in accordance with the specific assurance instructions set out by the TPA. It does not impact on our opinion and we do not consider that the outcome of this work is a threat to our role as external auditors. **Management threat:** This work was undertaken in accordance with the Assurance Instruction provided by the TPA. **Familiarity**: This threat is limited given the scale, nature and timing of the work. **Advocacy**: We will not act as advocates for the Authority in any aspect of this work. **Intimidation**: Not applicable
Total estimated fees	**£53,000**	
Total estimated fees as a percentage of the external audit fees (Authority and Pension Fund)	**40%**	

Appendix 5

Audit fees

Audit fees

As communicated to you in our External Audit Plan 2016/17, our scale fee for the audit of the Authority is £107,325 plus VAT and for the Pension Fund is £24,350 plus VAT. However, we propose an additional fee due to work undertaken in relation to the CIES restatement and the other significant risk areas identified in this report, and to cover the costs of the KPMG experts and specialists we have needed to engage in response to matters identified during the audit. This is still subject to final agreement and PSAA approval.

PSAA fee table – Authority Accounts		
Component of audit	**2016/17** *(planned fee)* £	**2015/16** *(actual fee)* £
Accounts opinion and use of resources work		
PSAA scale fee	107,325	107,325
Additional work to conclude our opinion (note 1)	TBC	14,052
Total fee for the Authority set by the PSAA	**107,325**	**121,377**

PSAA fee table – Pension Fund Accounts		
Component of audit	**2016/17** *(planned fee)* £	**2015/16** *(actual fee)* £
Accounts opinion work		
PSAA scale fee	24,350	24,350
Additional work to conclude our opinion (note 1)	TBC	2,097
Total fee for the Authority set by the PSAA	**24,350**	**26,447**

All fees are quoted exclusive of VAT.

Note 1: This is still subject to PSAA determination.

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