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Report to those charged with governance (ISA 260) 2013/14 (draft)

Lincolnshire County Council

September 2014

Contents

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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 has issued a document entitled *Statement of Responsibilities of Auditors and Audited Bodies*. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document which is available on the Audit Commission’s website at www.auditcommission.gov.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.

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 appointed engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG’s work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission’s complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, 3rd Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 03034448330.

Section one

Introduction

This document summarises:

- **the key issues identified during our audit of the financial statements for the year ended 31 March 2014 for the Authority; and**
- **our assessment of the Authority's arrangements to secure value for money.**

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 2013/14 financial statements; and
- the work to support our 2013/14 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) 2013/14* in respect of the Pension Fund administered by Lincolnshire County Council in September 2014.

Financial statements

Our *External Audit Plan 2013/14*, presented to you in March 2014, set out the four stages of our financial statements audit process.

This report focuses on the second and third stages of the process: control evaluation and substantive procedures. Our on site work for these took place during February 2014 (interim audit) and July/August 2014 (year end audit).

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 2013/14* explained our risk-based approach to VFM work, which follows guidance provided by the Audit Commission. We have now completed our work to support our 2013/14 VFM conclusion. This included:

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

Structure of this report

This report is structured as follows:

- Section two summarises the headline messages.
- Section three sets out our key findings from our audit work in relation to the 2013/14 financial statements.
- Section four outlines our key findings from our work on the VFM conclusion.

We have also reviewed your progress in implementing prior recommendations and this is detailed 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. Sections three and four of this report provide further details on each area.

Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2014. We will also report that the wording of your Annual Governance Statement accords with our understanding.
Audit adjustments	Our audit has not identified any material audit adjustments within the financial statements. There are no uncorrected differences identified by our audit of the Authority's financial statements that we need to report to you.
Key financial statements audit risks	We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.
Accounts production and audit process	The Authority has maintained its high standards in the quality of its draft accounts and the supporting working papers. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales. The Authority has made acceptable progress in relation to the recommendations we made in last year's report.
Control environment	The Authority's organisational control environment is effective overall, and we have not identified any significant weaknesses in controls over key financial systems.
Completion	At the date of this report our audit of the financial statements is substantially complete subject to final checks, including Director review, as part our completion procedures. Before we can issue our opinion we require a signed management representation letter. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.
VFM conclusion and risk areas	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 VFM conclusion by 30 September 2014.

Acknowledgements

We would like to take this opportunity to thank all of the Authority's staff who have assisted us during our audit.

Proposed opinion and audit differences

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

We anticipate issuing an unqualified audit opinion in relation to the Authority's financial statements by 30 September 2014.

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

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, 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 22 September 2014.

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.

We did not identify any material misstatements. We identified a small number of issues that have been adjusted by management. There are no uncorrected misstatements that we need to report to you.

The tables on the right illustrate the total impact of audit differences on the Authority's movements on the General Fund for the year and balance sheet as at 31 March 2014.

In addition, we identified a small number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting the United Kingdom 2013/14 ('the Code')*. We understand that the Authority will be addressing these where significant. We understand managers are to provide the Audit Committee with further information on all the significant changes made to the draft statements it considered at its July 2014 meeting.

Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

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

Movements on the General Fund 2013/14

£m	Pre-audit	Post-audit
Deficit on the provision of services	(12.7)	(13.2)
Adjustments between accounting basis & funding basis under Regulations	42.0	42.5
Transfers to earmarked reserves	(28.8)	(28.8)
Increase in General Fund	**0.5**	**0.5**

Balance Sheet as at 31 March 2014

£m	Pre-audit	Post-audit
Property, plant and equipment	1,337.5	1,337.5
Other long term assets	136.0	135.6
Current assets	231.7	232.9
Current liabilities	(102.3)	(103.6)
Long term liabilities	(1,187.7)	(1,187.7)
Net worth	**(415.2)**	**(414.7)**
General Fund	16.4	16.4
Other usable reserves	219.1	219.1
Unusable reserves	179.7	179.2
Total reserves	**(415.2)**	**(414.7)**

Key financial statements audit risks

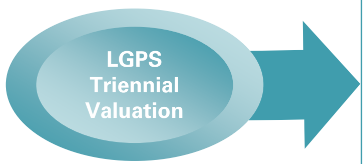
We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.

In our External Audit Plan 2013/14, presented to you in March 2014, we identified the key risks affecting the Authority's 2013/14 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 for each of the risks that are specific to the Authority.

Additionally, we considered the risk of management override of controls, which is a standard risk for all organisations.

Our 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, did not identify any issues.

Key audit risk	Issue	Findings
	During the year, the Pension Fund has undergone a triennial valuation with an effective date of 31 March 2013 in line with the Local Government Pension Scheme (Administration) Regulations 2008. 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. The pension numbers to be included in the financial statements for 2013/14 will be based on the output of the triennial valuation rolled forward to 31 March 2014. For 2014/15 and 2015/16 the actuary will then roll forward the valuation for accounting purposes based on more limited data. 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 anticipate that this will be identified as a risk area by some of the admitted bodies, whose pension liabilities represent a significant element of their balance sheet. This includes the Authority itself.	We have reviewed the data provided to the actuary to ensure: ▪ The process was undertaken in a suitable control environment; ▪ the accuracy of the information provided by agreeing a sample of data to source documentation; ▪ the reasonableness of the completeness of the data by conducting an analysis of movements during the period, and reviewing the overall amount of records provided. Our work did not identify any significant issues relating to the accounting or reporting requirements.

Accounts production and audit process

The Authority has maintained its high standards in the quality of its draft accounts and the supporting working papers.

Officers dealt efficiently with audit queries and the audit process could be completed within the planned timescales.

The Authority has made acceptable progress in relation to the recommendations we made in last year's report.

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 maintained its strong financial reporting processes. We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 20 June 2014, ahead of the 30 June deadline.
Quality of supporting working papers	Our *Accounts Audit Protocol* set out our working paper requirements for the audit. The quality of working papers provided was good and met the standards specified in our *Accounts Audit Protocol*. In particular, the explanatory note that officers provided on their proposed accounting treatment of the Energy from Waste incinerator was of a high standard.
Response to audit queries	Officers resolved audit queries in a reasonable time.

Prior year recommendations

As part of our audit we have specifically followed up the Authority's progress in addressing the recommendations in last year's ISA 260 report.

The Authority has made acceptable progress in relation to the recommendations we made in last year's report.

Appendix 1 provides further details.

Control environment

The Authority's organisational control environment is effective, and we were able to rely on the controls over the key financial systems.

During March 2014 we completed our control evaluation work. We did not issue an interim report as there were no significant issues arising from this work. For completeness we reflect on key findings from this work.

Organisational and control environment

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would have implications for our audit. We therefore obtain an understanding of the Authority's overall control environment and determine if appropriate controls have been implemented.

We did not identify any specific concerns in relation to your organisational and control environment that we need to report to you.

Internal Audit

We work with your internal auditors to assess the Authority's control framework and may seek to rely on any relevant work they have completed.

We did not need to rely this year on any specific pieces of Internal Audit work in carrying out our testing of the controls over the Authority's key financial systems. We have though taken their work into account in forming our assessment of the general control environment and financial reporting processes (including, for example, the accounting for schools' financial transactions), and in reviewing the Authority's Annual Governance Statement, and have not identified any concerns.

Controls over key financial systems

Where we have determined that this is the most efficient audit approach to take, we test selected controls that address key risks within the financial systems. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

We were able to rely on the controls selected and there are no specific issues or concerns that we need to report to the Authority.

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 2014, 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 Audit Commission's requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 3 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 Managers 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 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 2013/14 financial statements.

VFM conclusion

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

Subject to completing our consideration of the outcome of the judicial review of the libraries service, we have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Background

Auditors are required to give their statutory VFM conclusion based on two criteria specified by the Audit Commission. These consider whether the 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

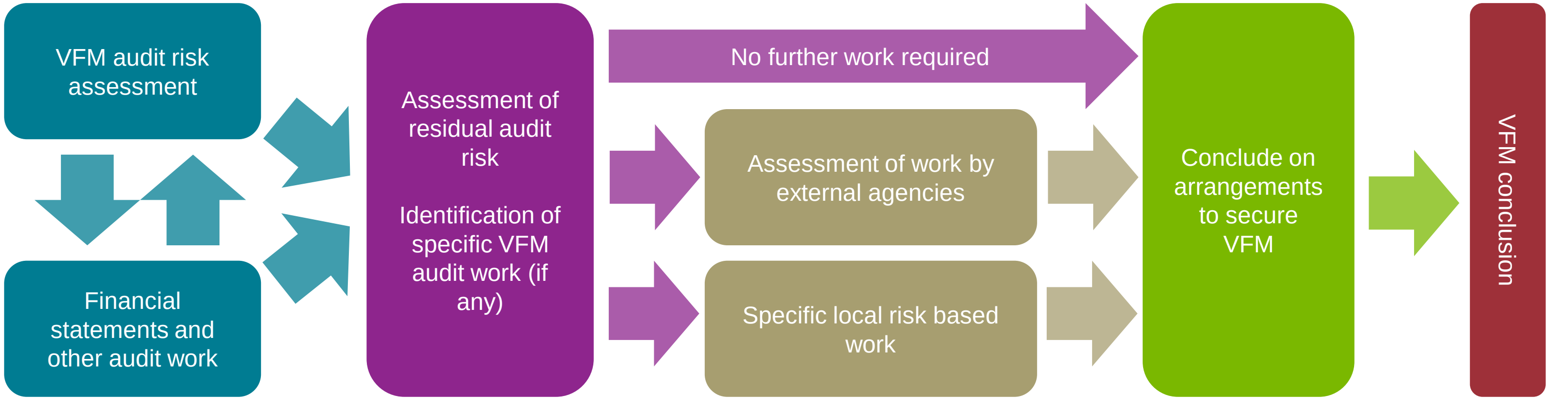
We performed a risk assessment earlier in the year and have reviewed this throughout the year.

We identified one significant risk to our VFM conclusion and have completed the additional work required. We have summarised the risk identified, the work carried out and our findings at page 10. We have also considered if the findings of the judicial review decision in respect of the reform of the libraries service in the context of our VFM conclusion responsibilities. We are currently completing that work, and subject to that completion, we are satisfied that the Authority's arrangements in relation to the identified risk were adequate.

Conclusion

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

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



Specific VFM risks

We have identified one specific VFM risk.

We are satisfied that the Authority's arrangements in relation to this risk area were adequate. We are currently completing our review of the Authority's response to the judicial review decision in relation to our responsibilities.

Work completed

In line with the risk-based approach set out on the previous page, and in our *External Audit Plan* we have:

- assessed the Authority's key business risks which are relevant to our VFM conclusion;
- identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;
- considered the results of relevant work by the Authority, other inspectorates and review agencies in relation to these risk areas; and
- completed specific local risk based work.

In addition to the work we set out in our audit plan, we have considered the outcome of the judicial review of the Authority's review of its libraries service. At the time of writing this report we are reviewing information provided by officers in relation to the Authority's response, and expect to complete our review shortly.

Key findings

Below we set out the findings in respect of those areas where we have identified in our audit plan the residual audit risk for our VFM conclusion.

We concluded that we needed to carry out additional work for this risk. This work is now complete and we also report on this below – we had no significant concerns to report, and provided feedback to officers as we did the work. We have agreed an additional fee of £5,712 for this work with the Authority, which has been approved by the Audit Commission.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
	The Authority has undertaken a major procurement exercise to re-award its contract for Corporate Support Services. The contract will become live from 1 April 2015. It is expected to have a value of £71m over five years and is forecast to deliver savings of £14m over the period. In view of the importance of this contract we needed assurance about the Authority's arrangements for the economy, efficiency and effectiveness criterion of the VFM conclusion.	We reviewed the arrangements and documentation used by the Authority for the selection of a provider, and the use of the OJEU Competitive Dialogue process. We provided feedback to officers on this piece of work and did not raise any significant issues. Based on the documentation that we have been provided with, the process had been clearly communicated to all parties and had been followed appropriately. We note that in the completed stages of the short-listing process, no challenges were received from any unsuccessful bidders. As part of our 2014/15 audit we will consider the arrangements in place for monitoring and mitigating the risks around handover of the contract to the new provider from 1 April 2015. A key issue will be reviewing the Authority's risk management around the transfer of data from the SAP general ledger system to Agresso, and we will seek to work with internal audit as much as possible.

Appendix 1: Follow up on previous year's recommendations

The Authority has made progress in relation to the recommendations we made in last year's report.

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

No.	Risk	2012/13 recommendation	Follow up comments
1	❷	**Related Party Transactions** Comply fully with the Code guidance when disclosing member and senior officers' declarations of potential related party transactions by including all types of transactions and not just those which are grant related.	We have not identified issues relating to the disclosure of the Related Party Transactions in the Authority's financial statements this year.
2	❸	**Annual Governance Statement** Shorten the timescale so that the Governance Group signs off the Annual Governance Statement in time for inclusion in the draft accounts presented for audit on or before 30 June each year.	A substantially complete draft Statement was available in July 2014 for the Audit Committee to consider alongside the draft financial statements. Management has continued to seek feedback on the draft Statement. The final Statement presented for the Committee's approval in September 2014 is not significantly different to the original draft, other than being updated for subsequent events.

Appendix 2: Audit differences

The are no uncorrected misstatements or corrected material misstatements that we need to report to you.

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). There are no uncorrected differences identified by our audit of the Authority's financial statements that we need to report to you.

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. No material misstatements were identified by our audit of the Authority's financial statements and we therefore have nothing to report to you in this regard.

We understand managers are to provide the Audit Committee at its 22 September 2014 meeting to approve the financial statements with a summary of all the significant changes made to the original draft.

Appendix 3: Declaration of independence and objectivity

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

Requirements

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

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

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

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

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

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.

For any the non audit work provided we have established the following safeguards to maintain the integrity of the audit team:

- Separate teams to conduct the audit and non audit work where appropriate
- Internal risk assessment process prior to conducting any non audit work
- External approval from the Audit Commission

Auditor declaration

In relation to the audit of the financial statements of Lincolnshire County Council for the financial year ending 31 March 2014, 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 Audit Commission's requirements in relation to independence and objectivity.

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