External Audit Plan 2014/15

Lincolnshire County Council

March 2015

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.audit-commission.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, 1st Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 03034448330.

Introduction

This document describes how we will deliver our audit work for Lincolnshire County Council and Lincolnshire Pension Fund.

Scope of this report

This document supplements our *Audit Fee Letter 2014/15* presented to you in April 2014. It describes how we will deliver our financial statements audit work for Lincolnshire County Council ('the Authority') and Lincolnshire Pension Fund ('the Pension Fund'). It also sets out our approach to value for money (VFM) work for 2014/15

We are required to satisfy ourselves that your accounts comply with statutory requirements and that proper practices have been observed in compiling them. We use a risk based audit approach.

The audit planning process and risk assessment is an on-going process and the assessment and fees in this plan will be kept under review and updated if necessary

Statutory responsibilities

Our statutory responsibilities and powers are set out in the *Audit Commission Act 1998* and the Audit Commission's *Code of Audit Practice*.

The Audit Commission will close at 31 March 2015. However our audit responsibilities under the *Audit Commission Act 1998* and the *Code of Audit Practice* in respect of the 2014/15 financial year remain unchanged.

The *Code of Audit Practice* summarises our responsibilities into two objectives, requiring us to audit/review and report on your:

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

The Audit Commission's *Statement of Responsibilities of Auditors and Audited Bodies* sets out the respective responsibilities of the auditor and the Authority.

Details of the new arrangements are set out in Appendix 4. The Authority can expect further communication from the Audit Commission and its successor bodies as the new arrangements are established. This plan restricts itself to reference to the existing arrangements.

Structure of this report

This report is structured as follows:

- Section 2 includes our headline messages, including any key risks identified this year for the financial statements audit and Value for Money arrangements Conclusion.
- Section 3 describes the approach we take for the audit of the financial statements.
- Section 4 provides further detail on the financial statements audit risks.
- Section 5 provides further detail on the audit risks for the pension fund
- Section 6 explains our approach to VFM arrangements work.
- Section 7 provides information on the audit team, our proposed deliverables, the timescales and fees for our work.

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

Audit approach	Our overall audit approach remains similar to last year with no fundamental changes . Our work is carried out in four stages and the timings for these, and specifically our on site work, have been agreed with management. Our audit strategy and plan remain flexible as risks and issues change throughout the year. We will review the initial assessments presented in this document throughout the year and should any new risks emerge we will evaluate these and respond accordingly.
Key financial statements audit risks	We have completed our initial risk assessment for the financial statements audit and have identified the following significant risk: ■ Accounting for Local Authority Maintained Schools. CIPFA have issued definitive clarification of existing guidance on significant entries to be included in the financial statements. This is described in more detail on page 13. We will assess this risk area as part of our interim work and conclude this work at year end. The Authority is introducing significant changes to its financial systems as part of its transition from Mouchel to Serco as its provider of financial support services. The Authority is replacing SAP with Agresso and the new system will be in place from April 2015. The 2014/15 accounts will be produced using SAP and we have discussed with managers the information required from the outgoing system for our audit. We will continue to liaise with managers regarding the accounts closedown and their arrangements for managing the operational impact of the system and organisational changes.
Key financial statements audit risks for the Pension Fund	Our initial risk assessment for the Pension Fund's financial statements audit has identified the following significant risk: ■ From 1 April 2014, all members of the Local Government Pension Scheme (LGPS) have automatically joined the new career average defined benefit scheme. There is a risk that pension administration systems have not been set up to correctly reflect the changes resulting from LGPS 2014 and will therefore not accurately calculate the pension benefits due to members. We have described this in more detail on page 14. We will assess the Authority's progress in addressing this risk area as part of our interim work and conclude this work at year end. As well as changing its main financial services provider the Authority is changing its pensions administration arrangements from April 2015, with West Yorkshire Pensions taking over from Mouchel. As part of this change the Pension Fund will need to move its membership and other administrative information from the current AXIS system to the incoming provider's CIVICA system. We have discussed with Pension Fund managers the information required for our audit from SAP and AXIS. We will continue to liaise with managers regarding accounts closedown and their arrangements for managing the impact of the ongoing changes.

Headlines (continued)

VFM audit approach	We have completed our initial risk assessment for the VFM conclusion and have identified the following significant risk: ■ The Authority has undertaken, through its Future Delivery of Support Services project, major procurement exercises to re-award its contracts for Corporate Support Services and Property Services. These services are to be supplied by new providers and the five year contracts will become live from 1 April 2015. The Authority has also agreed a change to its pension fund administration provider. In view of the importance of these changes to the Authority's contracts we need continued assurance about the Authority's arrangements for the economy, efficiency and effectiveness criterion of the VFM conclusion. These issues are described in more detail on page 20. .
Audit team, deliverables, timeline and fees	There have been two changes to the audit team from last year, with Tom Tandy and John Pressley taking on the in-charge roles for the audit of the Authority and Pension Fund respectively. Our main year end audits are currently planned to commence in June 2015. Upon conclusion of our work we will again present our findings to you in our *Report to Those Charged with Governance (ISA 260 Report)*. The overall planned fee for the 2014/15 audit is £167,450. This is unchanged from the position set out in our *Audit Fee Letter 2014/15*. This comprises £143,100 for the Authority's audit and £24,350 for the Pension Fund. We expect there to be an added element for the additional work required in relation to the significant risks identified in this Plan relating to the Authority and Pension Fund financial statements audit opinions and the VFM conclusion. We will update the Committee when the additional amount has been determined and agreed with officers and the Audit Commission.

Our audit approach

We undertake our work on your financial statements in four key stages during 2014:

- **Planning (January to February).**
- **Control Evaluation (February to March).**
- **Substantive Procedures (June to August).**
- **Completion (September).**

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We have summarised the four key stages of our financial statements audit process for you below.

	Stage	Activity	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
1	Planning	Update our business understanding and risk assessment.	●								
		Assess the organisational control environment.		●							
		Determine our audit strategy and plan the audit approach.		●							
		Issue our *Accounts Audit Protocol*.		●							
2	Control evaluation	Evaluate and test selected controls over key financial systems.			●						
		Liaise with Internal Audit.	●	●	●	●	●				
		Review the accounts production process.			●						
		Review progress on critical accounting matters			●		●				
3	Substantive procedures	Plan and perform substantive audit procedures.						●	●		
		Conclude on critical accounting matters.							●		
		Identify audit adjustments.							●		
		Review the Annual Governance Statement.								●	●
4	Completion	Declare our independence and objectivity.									●
		Obtain management representations.									●
		Report matters of governance interest.									●
		Form our audit opinion.									●

Our audit approach – planning (continued)

During January and February 2015 we complete our planning work.

We assess the key risks affecting the Authority's financial statements and discuss these with officers.

We assess if there are any weaknesses in respect of central processes that would impact on our audit.

Our planning work takes place in January and February 2015. This involves the following aspects:

Planning

- Update our business understanding and risk assessment including fraud risk.
- Assess the organisational control environment.
- Determine our audit strategy and plan the audit approach.
- Issue our *Accounts Audit Protocol*.

Business understanding and risk assessment

We update our understanding of the Authority's operations and identify any areas that will require particular attention during our audit of the Authority's financial statements.

We identify the key risks including risk of fraud affecting the Authority's financial statements. These are based on our knowledge of the Authority, our sector experience and our ongoing dialogue with Authority staff. Any risks identified to date through our risk assessment process are set out in this document. Our audit strategy and plan will, however, remain flexible as the risks and issues change throughout the year. It is the Authority's responsibility to adequately address these issues. We encourage the Authority to raise any technical issues with us as early as possible so that we can agree the accounting treatment in advance of the audit visit.

We meet with the finance team on a regular basis to consider issues and how they are addressed during the financial year end closedown and accounts preparation.

Organisational 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 impact on our audit.

In particular risk management, internal control and ethics and conduct have implications for our financial statements audit. The scope of the relevant work of your internal auditors also informs our risk assessment.

Audit strategy and approach to materiality

Our audit is performed in accordance with International Standards on Auditing (ISAs) (UK and Ireland). The Engagement Lead sets the overall direction of the audit and decides the nature and extent of audit activities. We design audit procedures in response to the risk that the financial statements are materially misstated. The materiality level is a matter of professional judgement and is set by the Engagement Lead.

In accordance with ISA 320 (UK&I) '*Audit materiality*', we plan and perform our audit to provide reasonable assurance that the financial statements are free from material misstatement and give a true and fair view. Information is considered material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.

Further details on assessment of materiality is set out on page 7 of this document.

Our audit approach –planning (continued)

When we determine our audit strategy we set a monetary materiality level for planning purposes.

For 2014/15 we have set this at the planning stage at £20 million for the Authority's accounts and £17 million for the Pension Fund accounts.

We will report to the Audit Committee all audit differences over £1 million for the Authority Accounts and £0.85 million for the Pension Fund accounts

Materiality

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

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

Materiality for planning purposes has been set at £20 million for the Authority's accounts, which equates to around 2 percent of gross expenditure in the previous year. Materiality for planning purposes has been set at £17 million for the Pension Fund accounts, which is around 2 percent of forecast year end total assets. We will revisit both of these assessments when the actual values for total gross expenditure and total assets are available.

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(UK&I) *'Communication with those charged with governance'*, we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK&I) 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 (UK&I), *'Evaluation of misstatements identified during the audit',* 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 £1 million. For the Pension Fund the trivial threshold is £0.85 million.

If 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.

Our audit approach – planning (continued)

We will issue our *Accounts audit protocol* following completion of our planning work.

Accounts audit protocol

At the end of our planning work we will issue our *Accounts Audit Protocol*. Separate documents will be issued for the Authority and the Pension Fund .These important documents sets out our audit approach and timetable. It also summarises the working papers and other evidence we require the Authority to provide during our interim and final accounts visits.

We met with the finance team to discuss mutual learning points from the 2013/14 audits. These will be incorporated into our work plan for 2014/15. We revisit progress against areas identified for development as the audits progress.

Our audit approach – control evaluation

During March 2015 we will complete our interim audit work.

We assess if controls over key financial systems were effective during 2014/15.

We work with your finance team and the pensions team to enhance the efficiency of the accounts audits.

We will report any significant findings arising from our work to the Audit Committee.

Our on site interim visits will be completed during March. During this time we will complete work in the following areas:

Control Evaluation	
	- Evaluate and test controls over key financial systems identified as part of our risk assessment. - Liaise with internal audit regarding relevant audit work. - Review the accounts production process. - Review progress on critical accounting matters.

Controls over key financial systems

We update our understanding of the Authority’s and Pension Fund’s key financial processes where our risk assessment has identified that these are relevant to our final accounts audits and where we have determined that this is the most efficient audit approach to take. We confirm our understanding by completing walkthroughs for these systems. We then test selected controls that address key risks within these systems. The strength of the control framework informs the substantive testing we complete during our final accounts visits.

We liaise with internal Audit and take their reports on topics which are relevant to our audit opinions into account. If appropriate we review their detailed work in relation to specific testing on which we plan to rely.

Critical accounting matters

We will discuss the work completed to address the specific risks we identified at the planning stage. Wherever possible, we seek to review relevant workings and evidence and agree the accounting treatment as part of our interim work.

If there are any significant findings arising from our interim work we will present these to the Audit Committee in July 2015.

Our audit approach – substantive procedures

During June to August 2015 we will be on site for our substantive work.

We complete detailed testing of accounts and disclosures and conclude on critical accounting matters, such as specific risk areas. We then agree any audit adjustments required to the financial statements.

We also review the Annual Governance Statement for consistency with our understanding.

We will present our *ISA 260 Report* to the Audit Committee in September 2015.

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Our final accounts visits on site have been provisionally scheduled for the period June to August. During this time, we will complete the following work:

Substantive Procedures

- Plan and perform substantive audit procedures.
- Conclude on critical accounting matters.
- Identify and assess any audit adjustments.
- Review the Annual Governance Statement.

Substantive audit procedures

We complete detailed testing on significant balances and disclosures. The extent of our work is determined by the Engagement Lead based on various factors such as our overall assessment of the Authority's and Pension Fund's control environment, the effectiveness of controls over individual systems and the management of specific risk factors.

Critical accounting matters

We conclude our testing of key risk areas identified at the planning stage and any additional issues that may have emerged since.

We will discuss with management our early findings of the approach to addressing the key risk areas for the Authority and Pension Fund accounts prior to reporting to the Audit Committee in September 2015.

Audit adjustments

During our on site work, we will meet with the officers on a regular basis to discuss the progress of the audit, any differences found and any other issues emerging.

At the end of our on site visits, we will hold a closure meeting, where we will provide a schedule of audit differences and agree a timetable for the completion stage and the accounts sign off.

To comply with auditing standards, we are required to report uncorrected audit differences to the Audit Committee. 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.

Annual Governance Statement

We are also required to satisfy ourselves that your Annual Governance Statement complies with the applicable framework and is consistent with our understanding of your operations. Our review of the work of internal audit and consideration of your risk management and governance arrangements are part of this.

We report the findings of our audit of the financial statements work in our *ISA 260 Report*, which we will issue in September 2015.

Pension Fund Annual Report

We also issue an opinion on the consistency of the Pension Fund's accounts included in the *Pension Fund Annual Report* with those included in the Statement of Accounts We intend to issue this opinion at the same time as our opinion on the accounts.

Our audit approach – other matters

In addition to the financial statements, we also review the Authority's Whole of Government Accounts pack.

We may need to undertake additional work if we receive objections to the accounts from local electors.

We will communicate with you throughout the year, both formally and informally.

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Whole of government accounts (WGA)

We are required to review your WGA consolidation and undertake the work specified under the approach that is agreed with HM Treasury and the National Audit Office. Deadlines for production of the pack and the specified audit approach for 2014/15 have not yet been confirmed.

Elector challenge

The Audit Commission Act 1998 gives electors certain rights. These are:

- the right to inspect the accounts;
- the right to ask the auditor questions about the accounts; and
- the right to object to the accounts.

As a result of these rights, in particular the right to object to the accounts, we may need to undertake additional work to form our decision on the elector's objection. The additional work could range from a small piece of work where we interview an officer and review evidence to form our decision, to a more detailed piece of work, where we have to interview a range of officers, review significant amounts of evidence and seek legal representations on the issues raised.

The costs incurred in responding to specific questions or objections raised by electors is not part of the fee. This work will be charged in accordance with the Audit Commission's fee scales.

Reporting and communication

Reporting is a key part of the audit process, not only in communicating the audit findings for the year, but also in ensuring the audit team are accountable to you in addressing the issues identified as part of the audit strategy. Throughout the year we will communicate with you through meetings with the finance team and the Audit Committee. Our deliverables are included on page 19.

Independence and objectivity confirmation

Professional standards require auditors to communicate to those charged with governance, at least annually, all relationships that may bear on the firm's independence and the objectivity of the audit engagement partner and audit staff. The standards also place requirements on auditors in relation to integrity, objectivity and independence.

The standards define 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case this is the Audit Committee.

KPMG LLP is committed to being and being seen to be independent. APB Ethical Standard 1 *Integrity, Objectivity and Independence* requires us to communicate to you in writing all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Engagement Lead and the audit team.

Appendix 1 provides further detail on auditors' responsibilities regarding independence and objectivity.

Confirmation statement

We confirm that as of March 2015 in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Engagement Lead and audit team is not impaired.

Key financial statements audit risks

In this section we set out our assessment of the significant risks or other key areas of audit focus of the Authority's financial statements for 2014/15.

For each key risk we have outlined the impact on our audit plan.

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Professional standards require us to consider two standard risks for all organisations. We are not elaborating on these standard risks in this plan but consider them as a matter of course in our audit and will include any findings arising from our work in our *ISA 260 Report*.

- Management override of controls – Management is typically in a powerful position to perpetrate fraud owing to 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. In line with our methodology, we carry 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.
- Fraudulent revenue recognition – We do not consider this to be a significant risk for local authorities as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures.

Appendix 3 covers more details on our assessment of fraud risk.

The table on page 13 sets out the significant risk we have identified through our planning work that is specific to the audit of the Authority's financial statements for 2014/15.

The Authority is introducing significant changes to its financial systems as part of its transition from Mouchel to Serco as its provider of financial support services. The Authority is replacing SAP with Agresso and the new system will be in place from April 2015. The 2014/15 accounts will be produced using SAP and we have discussed with managers the information required from the outgoing system for our audit. We will continue to liaise with managers regarding the accounts closedown and their arrangements for managing the operational impact of the system and organisational changes.

We will revisit our assessment throughout the year and should any additional risks present themselves we will adjust our audit strategy as necessary.

Key financial statements audit risks (continued)

We have outlined the impact of this risk on our audit plan.

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Key audit risks	Impact on audit
Accounting for local authority maintained schools **Audit areas affected** - Property, plant and equipment - CIES (income/ Expenditure)	**Risk** LAAP Bulletin 101 *Accounting for School Assets used by Local Authority Maintained Schools* issued in December 2014 has been published to assist practitioners with the application of the Code in this respect. The challenges relate to school assets owned by third parties such as church bodies and made available to school governing bodies under a variety of arrangements. This includes assets used by Voluntary-Aided (VA) and Voluntary-Controlled (VC) Schools as well as Foundation Schools. The Authority will need to review the agreements under which assets are used by VA/VC and Foundation schools and apply the relevant tests of control in the case of assets made available free of charge, or risks and rewards of ownership in the case of assets made available under leases. This is a key area of judgement and there is a risk that the Authority could incorrectly omit school assets from, or include school assets in, its balance sheet. Particular risks surround the recognition of Foundation School assets which may or may not be held in Trust. The Authority should pay particular attention to the nature of the relationship between the Trustees and the school governing body to determine whether the school controls the Trust and the assets should therefore be consolidated into the balance sheet. **Our proposed audit work** As part of our audit, we will ensure the Authority is aware of the latest guidance and review the judgements it has made. This will include: - Determining whether the Authority has identified all relevant maintained schools within its area and undertaken a review of the agreements underpinning the use of school assets by VA, VC and Foundation schools; - Considering the Authority's application of the relevant accounting standards to account for these schools and challenging its judgements where necessary; and - Determining whether the basis of valuation of any assets which are brought onto the balance sheet at 1 April 2013 is appropriate.

Key financial statements audit risks – the Pension Fund

In this section we set out our assessment of the significant risk to the audit of the Pension Fund's financial statements for 2014/15, and its impact on our audit plan.

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As for the Authority's financial statements, professional standards require us to consider two standard risks for all Pension Funds. To recap, these are:

- Management override of controls – Management is typically in a powerful position to perpetrate fraud owing to 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. In line with our methodology, we carry 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.
- Fraudulent revenue recognition – We do not consider this to be a significant risk for pension funds as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures.

The table below sets out the significant risk we have identified through our planning work that is specific to the audit of the Pension Fund's financial statements for 2014/15. We will revisit our assessment throughout the year and should any additional risks present themselves we will adjust our audit strategy as necessary.

As well as changing its main financial services provider the Authority is changing its pensions administration arrangements from April 2015, with West Yorkshire Pensions taking over from Mouchel. As part of this change the Pension Fund will need to move its membership and other administrative information from the current AXIS system to the incoming provider's CIVICA system. We have discussed with Pension Fund managers the information required for our audit from SAP and AXIS. We will continue to liaise with managers regarding accounts closedown and their arrangements for managing the impact of the ongoing changes.

Key audit risks	Impact on audit
LGPS reform **Audit areas affected** ▪ Benefits	**Risk** From 1 April 2014, all members of the LGPS have automatically joined the new career average defined benefit scheme. The new scheme provides more flexibility on when members can take their pension and also how much they pay in. There is a risk that pension administration systems have not been set up to correctly reflect the changes resulting from LGPS 2014 and will therefore not accurately calculate the pension benefits due to members. While any errors in the system are unlikely to result in material misstatements in 2014/15, the possible cumulative effect in future years means that specific audit work is needed on ensuring that the changes required to the system have been accurately reflected. **Our audit work** We will review the controls and processes that the Pension Fund have put in place to accurately capture the data required by LGPS 2014. Our work will also focus on testing that the system has been set up to accurately calculate future benefit entitlement.

Key financial statements audit risks – the Pension Fund (continued)

We will assess the progress made in implementing the new Pension Fund governance arrangements implemented from 1 April 2015.

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Other areas of audit focus

From 1 April 2015, the Pensions Regulator is responsible for regulating the governance and administration of public service pension schemes, which includes the Local Government Pension Scheme. Scheme managers and pension board members must comply with a number of legal requirements, such as the establishment of a pension board with an equal number of employer representatives and member representatives. Pension board members for a public service pension scheme must also meet certain legal requirements that relate to their knowledge and understanding.

We will discuss with managers the progress made in implementing these new governance arrangements and report our findings to the September 2015 Audit Committee through our 'Report to those Charged with Governance' (ISA 260 Report).

VFM audit approach

Our approach to VFM work follows guidance provided by the Audit Commission.

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Background to approach to VFM work

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

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

To provide stability for auditors and audited bodies, the Audit Commission has kept the VFM audit methodology unchanged from last year. There are only relatively minor amendments to reflect the key issues facing the local government sector.

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

Specified criteria for VFM conclusion	Focus of the criteria	Sub-sections
The organisation has proper arrangements in place for securing **financial resilience**.	The organisation has robust systems and processes to: ■ manage effectively financial risks and opportunities; and ■ secure a stable financial position that enables it to continue to operate for the foreseeable future.	■ Financial governance ■ Financial planning ■ Financial control
The organisation has proper arrangements for challenging how it **secures economy, efficiency and effectiveness**.	The organisation is prioritising its resources within tighter budgets, for example by: ■ achieving cost reductions; and ■ improving efficiency and productivity.	■ Prioritising resources ■ Improving efficiency and productivity

VFM audit approach (continued)

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

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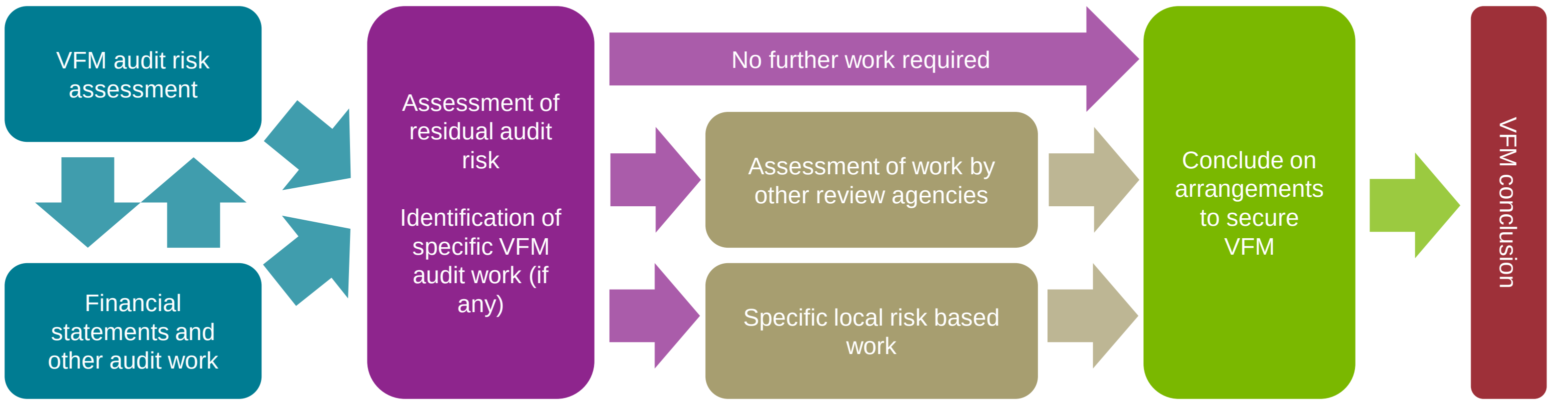
Overview of the VFM audit approach

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



Each of these stages are summarised further below.

VFM audit stage	Audit approach
VFM audit risk assessment	We consider the relevance and significance of the potential business risks faced by all local authorities, and other risks that apply specifically to the Authority. These are the significant operational and financial risks in achieving statutory functions and objectives, which are relevant to auditors' responsibilities under the *Code of Audit Practice*. In doing so we consider: ■ the Authority's own assessment of the risks it faces, and its arrangements to manage and address its risks; ■ information from the Audit Commission's VFM profile tool ; ■ evidence gained from previous audit work, including the response to that work; and ■ the work of other inspectorates and review agencies.

VFM audit approach (continued)

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

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

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VFM audit stage	Audit approach
Linkages with financial statements and other audit work	There is a degree of overlap between the work we do as part of the VFM audit and our financial statements audit. For example, our financial statements audit includes an assessment and testing of the Authority's organisational control environment, including the Authority's financial management and governance arrangements, many aspects of which are relevant to our VFM audit responsibilities. We have always sought to avoid duplication of audit effort by integrating our financial statements and VFM work, and this will continue. We will therefore draw upon relevant aspects of our financial statements audit work to inform the VFM audit.
Assessment of residual audit risk	It is possible that further audit work may be necessary in some areas to ensure sufficient coverage of the two VFM criteria. Such work may involve interviews with relevant officers and /or the review of documents such as policies, plans and minutes. We may also refer to any self assessment the Authority may prepare against the characteristics. To inform any further work we must draw together an assessment of residual audit risk, taking account of the work undertaken already. This will identify those areas requiring further specific audit work to inform the VFM conclusion. At this stage it is not possible to indicate the number or type of residual audit risks that might require additional audit work, and therefore the overall scale of work cannot be easily predicted. If a significant amount of work is necessary then we will need to review the adequacy of our agreed audit fee.
Identification of specific VFM audit work	If we identify residual audit risks, then we will highlight the risk to the Authority and consider the most appropriate audit response in each case, including: ■ considering the results of work by the Authority, inspectorates and other review agencies; and ■ carrying out local risk-based work to form a view on the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources.

VFM audit approach (continued)

Where relevant, we may draw upon the range of audit tools and review guides developed by the Audit Commission.

We will conclude on the results of the VFM audit through our ISA 260 Report.

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VFM audit stage	Audit approach
Delivery of local risk based work	Depending on the nature of the residual audit risk identified, we may be able to draw on audit tools and sources of guidance when undertaking specific local risk-based audit work, such as: ■ local savings review guides based on selected previous Audit Commission national studies; and ■ update briefings for previous Audit Commission studies. The tools and guides will support our work where we have identified a local risk that is relevant to them. For any residual audit risks that relate to issues not covered by one of these tools, we will develop an appropriate audit approach drawing on the detailed VFM guidance and other sources of information.
Concluding on VFM arrangements	At the conclusion of the VFM audit we will consider the results of the work undertaken and assess the assurance obtained against each of the VFM themes regarding the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources. If any issues are identified that may be significant to this assessment, and in particular if there are issues that indicate we may need to consider qualifying our VFM conclusion, we will discuss these with management as soon as possible. Such issues will also be considered more widely as part of KPMG's quality control processes, to help ensure the consistency of auditors' decisions.
Reporting	On the following page, we report the results of our initial risk assessment. We will report on the results of the VFM audit through our *ISA 260 Report*. This will summarise any specific matters arising, and the basis for our overall conclusion. The key output from the work will be the VFM conclusion (i.e. our opinion on the Authority's arrangements for securing VFM), which forms part of our audit report.

VFM audit approach (continued)

We have identified one specific VFM risks.

In most 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.

We will carry out additional risk-based work in relation to the changes to the Council arrangements arising from the Future Delivery of Support Services project and the change in the pensions administration provider.

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In line with the risk-based approach set out on the previous page, 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, the Audit Commission, other inspectorates and review agencies in relation to these risk areas; and
- concluded to what extent we need to carry out additional risk-based work.

Below we set out our preliminary findings in respect of those areas where we have identified a residual audit risk for our VFM conclusion,

We will report our final conclusions in our *ISA 260 Report 2014/15*.

Key VFM risk	Risk description and link to VFM conclusion
Future Delivery of support Services project	The Authority has undertaken, through its Future Delivery of Support Services project, major procurement exercises to re-award its contracts for Corporate Support Services and Property Services. These services have been provided through the current contract with Mouchel since 2000. Two separate contracts have been let, to Serco and VINCIMouchel respectively, and the five year contracts will become live from 1 April 2015. The combined value over the life of the projects is over £117m and they are forecast to deliver savings totalling £16m over that period. The Authority has also agreed a change to its pension fund administration provider. It will move from its current provider, Mouchel, and enter into a new shared service arrangement with West Yorkshire Pension Fund from 1 April 2015. In view of the importance of these changes to the Authority's contracts we need assurance about the Authority's arrangements for the economy, efficiency and effectiveness criterion of the VFM conclusion. We have already, during our 2013/14 audit, reviewed the procurement arrangements and documentation used by the Authority for the selection of its provider for the Corporate Support Services contract. We did not raise any significant issues with management in the course of that work. We will assess the arrangements the Authority has in place for monitoring and mitigating the risks around handover of the two contracts to the new providers from 1 April 2015. We will, in the course of this work liaise closely with Internal Audit and review the Authority's arrangements for managing the risks around the transfer of data from the SAP general ledger system to Agresso and the implementation of the new system. We will also assess the arrangements in place for monitoring and mitigating the risks around the move to the new pension fund administration provider and liaise with Internal Audit regarding their work on the transfer of data to the new system.

Audit team

Tony Crawley (Director) and Mike Norman (Manager) were part of the audit team of Lincolnshire County Council last year. Tom Tandy (Assistant Manager) and John Pressley (Assistant Manager) are new to the audit team for 2014/15. Contact details are shown on page 1.

The audit team will be assisted by other KPMG specialists as necessary.

Tony Crawley

Director

"My role is to lead our team and ensure the delivery of a high quality, valued added external audit opinion.

I will be the main point of contact for the Audit Committee and Chief Executive."

Mike Norman

Manager

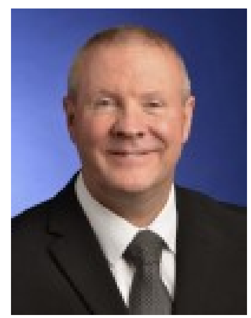
"I am responsible for the management, review and delivery of the audit of the Authority and of the Pension Fund.

I will liaise with the County Finance Officer, Audit and Risk Manager and Pensions managers"

Tom Tandy

Assistant Manager

"I will be responsible for the on-site delivery of our work on the Authority's financial statements. I will liaise with the Finance Team. I will also supervise the work of our audit assistants."



John Pressley

Assistant Manager

"I am responsible for the management, review and delivery of the audit of the Pension Fund.

I will liaise with the Pensions team."

Audit deliverables

At the end of each stage of our audit we issue certain deliverables, including reports, statements and opinions.

Our key deliverables will be delivered to a high standard and on time.

We will discuss and agree each report as appropriate with the Authority's officers prior to publication.

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Deliverable	Purpose	Committee dates
Planning		
External Audit Plan	■ Outlines our audit approach. ■ Identifies areas of audit focus and planned procedures.	March 2015
Control evaluation and Substantive procedures		
Reports to Those Charged with Governance (ISA 260 Reports) for the Authority and Pension Fund	■ Details any control and process issues. ■ Details the resolution of key audit issues. ■ Communicates adjusted and unadjusted audit differences. ■ Highlights performance improvement recommendations identified during our audit. ■ Comments on the Authority's value for money arrangements.	September 2015
Completion		
Auditor's Report	■ Provides an opinion on the Authority and Pension Fund accounts (including the Annual Governance Statement). ■ Concludes on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the VFM conclusion).	September 2015
Whole of Government Accounts	■ Provide our assurance statement on the Authority's WGA pack submission.	September 2015
Pension Fund Annual Report	■ We provide an opinion on the consistency of the Pension Fund annual report with the Pension Fund accounts,	September 2015
Annual Audit Letter	■ Summarises the outcomes and the key issues arising from our audit work for the year.	November 2015

Audit timeline

We will be in continuous dialogue with you throughout the audit.

Key formal interactions with the Audit Committee are:

- **March – External Audit Plan;**
- **September – ISA 260 Report;**
- **November – Annual Audit Letter.**

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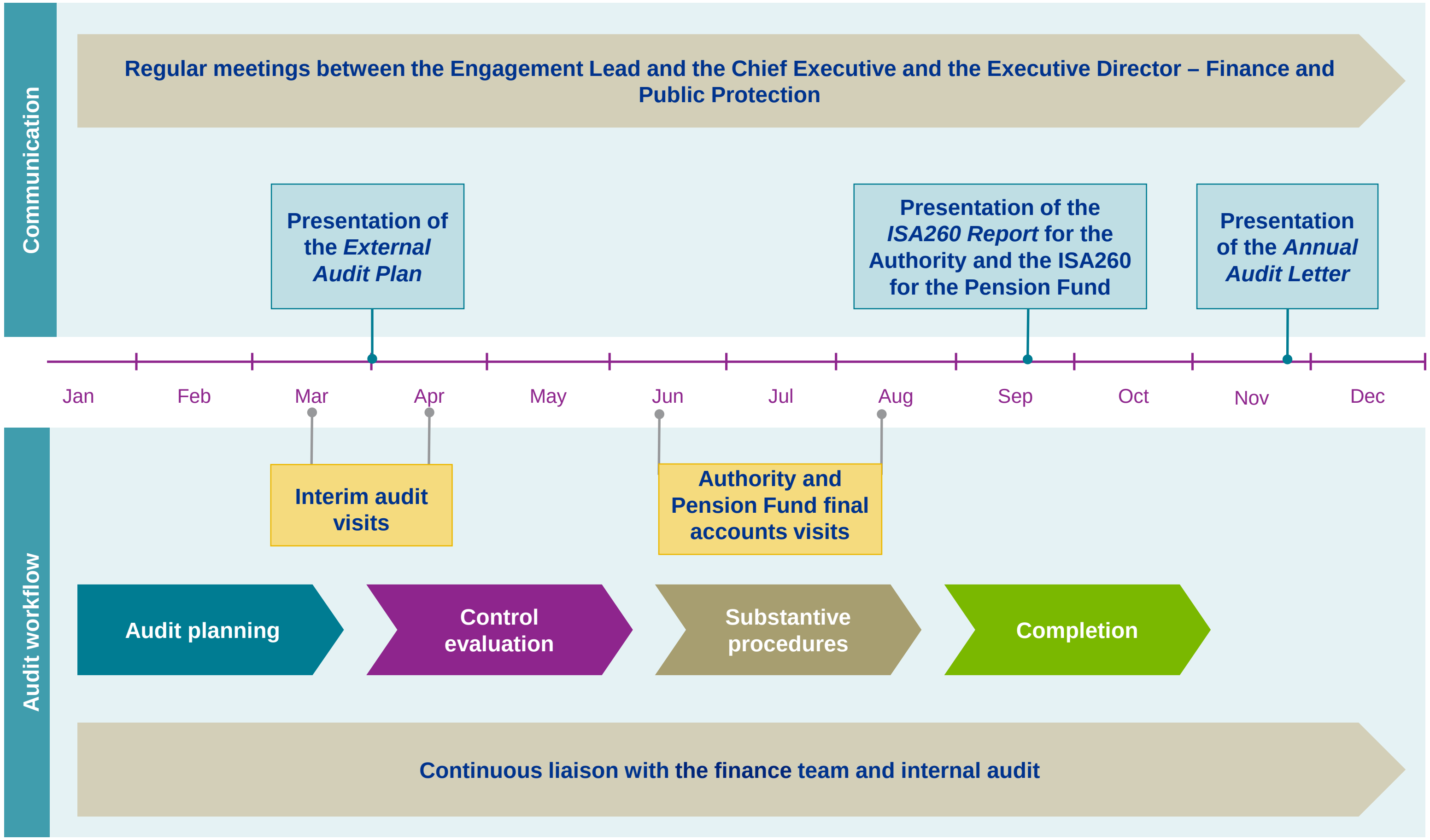
We work with the finance team and internal audit throughout the year.

Our main work on site will be our:

- **Interim audit visits during March and April.**
- **Final accounts audits between June and August.**



Key: ● Audit Committee meetings.

The planned fee for the 2014/15 audit of the Authority is £143,100. The planned fee for our audit of the Pension Fund is £24,350. The fee has not changed from that set out in our *Audit Fee Letter 2014/15* issued in April 2014.

Our audit fee remains indicative and based on you meeting our expectations of your support.

Meeting these expectations will help the delivery of our audit within the proposed audit fee.

Audit fee

Our September 2014 *Audit Fee Letter 2014/15* first set out our fees for the 2014/15 audit. We have not considered it necessary to make any changes to the agreed fees at this stage.

Element of the audit	2014/15 (planned)	2013/14 (actual)
Main audit fee	£143,100	£148,815
Pension Fund audit fee	£24,350	£24,350

Our main audit fee includes our work on the VFM conclusion and our audit of the Authority's financial statements. In 2013/14 we charged the Authority an additional £5,715 relating to work required to review your arrangements for the Future Delivery of Support Services, which had been identified as a significant risk to the VFM Conclusion. If we are required to undertake additional work to address the significant risks to the authority and Pension Fund financial statements audit opinions and the VFM conclusion identified in this plan for 2014/15 an additional fee will be charged. We will agree the additional fee for that work with officers and then with the Audit Commission, and update the Committee accordingly.

Audit fee assumptions

The fee is based on a number of assumptions, including that you will provide us with complete and materially accurate financial statements, with good quality supporting working papers, within agreed timeframes. It is imperative that you achieve this. If this is not the case and we have to complete more work than was envisaged, we will need to charge additional fees for this work. In setting the fee, we have assumed:

- the level of risk in relation to the audit of the financial statements is not significantly different from that identified for 2013/14;
- you will inform us of any significant developments impacting on our audit;
- you will identify and implement any changes required under the *CIPFA Code of Practice on Local Authority Accounting in the UK 2014/15* within your 2014/15 financial statements;
- you will comply with the expectations set out in our *Accounts Audit Protocol*, including:
  - the financial statements are made available for audit in line with the agreed timescales;
  - good quality working papers and records will be provided at the start of the final accounts audit;
  - requested information will be provided within the agreed timescales;
  - prompt responses will be provided to queries and draft reports;
- any internal audit work on which we rely meets appropriate professional standards; and
- additional work will not be required to address questions or objections raised by local government electors or for special investigations such as those arising from disclosures under the Public Interest Disclosure Act 1998.

The Audit Commission requires us to inform you of specific actions you could take to keep the audit fee low. Future audit fees can be kept low if the Authority achieves an efficient and well-controlled financial closedown and accounts production process which complies with good practice and appropriately addresses new accounting developments and risk areas.

Changes to the audit plan

Changes to this plan and the audit fee may be necessary if:

- new significant audit risks emerge;
- additional work is required of us by the Audit Commission or other regulators; and
- additional work is required as a result of changes in legislation, professional standards or financial reporting requirements.

If changes to this plan and the audit fee are required, we will discuss and agree these initially with the Executive Director – Finance and Public Protection.

Appendix 1: Independence and objectivity requirements

This appendix summarises auditors' responsibilities regarding independence and objectivity.

Independence and objectivity

Auditors are required by the Code to:

- carry out their work with independence and objectivity;
- exercise their professional judgement and act independently of both the Commission and the audited body;
- maintain an objective attitude at all times and not act in any way that might give rise to, or be perceived to give rise to, a conflict of interest; and
- resist any improper attempt to influence their judgement in the conduct of the audit.

In addition, the Code specifies that auditors should not carry out work for an audited body that does not relate directly to the discharge of the auditors' functions under the Code. If the Authority invites us to carry out risk-based work in a particular area, which cannot otherwise be justified to support our audit conclusions, it will be clearly differentiated as work carried out under section 35 of the Audit Commission Act 1998.

The Code also states that the Commission issues guidance under its powers to appoint auditors and to determine their terms of appointment. The Standing Guidance for Auditors includes several references to arrangements designed to support and reinforce the requirements relating to independence, which auditors must comply with. These are as follows:

- Auditors and senior members of their staff who are directly involved in the management, supervision or delivery of Commission-related work, and senior members of their audit teams should not take part in political activity.
- No member or employee of the firm should accept or hold an appointment as a member of an audited body whose auditor is, or is proposed to be, from the same firm. In addition, no member or employee of the firm should accept or hold such appointments at related bodies, such as those linked to the audited body through a strategic partnership.
- Audit staff are expected not to accept appointments as Governors at certain types of schools within the local authority.
- Auditors and their staff should not be employed in any capacity (whether paid or unpaid) by an audited body or other organisation providing services to an audited body whilst being employed by the firm.
- Firms are expected to comply with the requirements of the Commission's protocols on provision of personal financial or tax advice to certain senior individuals at audited bodies, independence considerations in relation to procurement of services at audited bodies, and area wide internal audit work.
- Auditors appointed by the Commission should not accept engagements which involve commenting on the performance of other Commission auditors on Commission work without first consulting the Commission.
- Auditors are expected to comply with the Commission's policy for the Engagement Lead to be changed on a periodic basis.
- Audit suppliers are required to obtain the Commission's written approval prior to changing any Engagement Lead in respect of each audited body.
- Certain other staff changes or appointments require positive action to be taken by Firms as set out in the standing guidance.

Appendix 2: KPMG Audit Quality Framework

We continually focus on delivering a high quality audit.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Appendix 2: KPMG Audit Quality Framework (continued)

We continually focus on delivering a high quality audit.

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

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

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

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

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

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

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

Our quality review results

We are able to evidence the quality of our audits through the results of Audit Commission reviews. The Audit Commission publishes information on the quality of work provided by KPMG (and all other firms) for audits undertaken on behalf of them (http://www.audit-commission.gov.uk/audit-regime/audit-quality-review-programme/principal-audits/kpmg-audit-quality).

The latest Annual Regulatory Compliance and Quality Report (issued June 2014) showed that we are meeting the Audit Commission's overall audit quality and regularity compliance requirements.

Appendix 3 : Assessment of fraud risk

We are required to consider fraud and the impact that this has on our audit approach.

We will update our risk assessment throughout the audit process and adapt our approach accordingly.

Members /Officers responsibilities

- Adopt sound accounting policies.
- With oversight from those charged with governance, establish and maintain internal control, including controls to prevent, deter and detect fraud.
- Establish proper tone/culture/ethics.
- Require periodic confirmation by employees of their responsibilities.
- Take appropriate action in response to actual, suspected or alleged fraud.
- Disclose to Audit Committee and auditors:
  - any significant deficiencies in internal controls.
  - any fraud involving those with a significant role in internal controls.

KPMG's identification of fraud risk factors

- Review of accounting policies.
- Results of analytical procedures.
- Procedures to identify fraud risk factors.
- Discussion amongst engagement personnel.
- Enquiries of management, Audit Committee, and others.
- Evaluate controls that prevent, deter, and detect fraud.

KPMG's response to identified fraud risk factors

- Accounting policy assessment.
- Evaluate design of mitigating controls.
- Test effectiveness of controls.
- Address management override of controls.
- Perform substantive audit procedures.
- Evaluate all audit evidence.
- Communicate to Audit Committee and management./officers

KPMG's identified fraud risk factors

- We will monitor the following areas throughout the year and adapt our audit approach accordingly.
  - Revenue recognition.
  - Management override of controls.

Appendix 4: Transfer of Audit Commission's functions

The Audit Commission will be writing to audited bodies and other stakeholders in the coming months with more information about the transfer of the Commission's regulatory and other functions.

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From 1 April 2015 a transitional body, Public Sector Audit Appointments Limited (PSAA), established by the Local Government Association (LGA) as an independent company, will oversee the Commission's audit contracts until they end in 2017 (or 2020 if extended by DCLG). PSAA's responsibilities will include setting fees, appointing auditors and monitoring the quality of auditors' work. The responsibility for making arrangements for publishing the Commission's value for money profiles tool will also transfer to PSAA.

From 1 April 2015, the Commission's other functions will transfer to new organisations:

- responsibility for publishing the statutory Code of Audit Practice and guidance for auditors will transfer to the National Audit Office (NAO) for audits of the accounts from 2015/16;
- the Commission's responsibilities for local value for money studies will also transfer to the NAO; and
- the National Fraud Initiative (NFI) will transfer to the Cabinet Office.

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