



External Audit Plan 2015/2016

Lincolnshire County
Council

March 2016

Financial Statement Audit



There are no significant changes to the Code of Practice on Local Authority Accounting in 2015/16, which provides stability in terms of the accounting standards the Authority need to comply with.

Materiality

Materiality for planning purposes has set at **£12 million** for the Authority and **£16 million** for the Pension Fund.

We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance and this has been set at **£0.6 million** for the Authority and **£0.8 million** for the Pension Fund.

Significant risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error have been identified as:

- The changes to the Authority's corporate financial systems in the year, which affects the accounts of the Authority and Pension Fund; and
- The change in the Pension Fund's pensions administration support services provider.

Other areas of audit focus

Those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding have been identified as:

- The changes to the CIPFA Code of Accounting Practice, which include new requirements for the valuation of surplus assets and narrative reporting; and
- The disclosure and accounting arrangements for Lincolnshire's Better Care Fund, which the Authority hosts.

See pages 3 to 5 for more details.

Value for Money Arrangements work



The National Audit Office has issued new guidance for the VFM audit which applies from the 2015/16 audit year. The approach is broadly similar in concept to the previous VFM audit regime, but there are some notable changes:

- There is a new overall criterion on which the auditor's VFM conclusion is based; and
- This overall criterion is supported by three new sub-criteria.

Our risk assessment regarding your arrangements to secure value for money have identified the following VFM significant risks:

- Your concerns regarding the operation of the Serco support services contract; and
- Difficulties in monitoring your 2015/16 budget and shaping your medium term financial strategy.

See pages 6 to 9 for more details.

Logistics



Our team is:

- John Cornett - Director
- Mike Norman - Manager
- John Pressley – Assistant Manager

More details are on **page 12**.

Our work will be completed in four phases from December to September and our key deliverables are this Audit Plan and a Report to those charged with Governance as outlined on **page 11**.

The scale fee for the audit is £107,325 (£143,100 2014/2015) for the Authority and £24,350 (£24,350 2014/15) for the Pension Fund see **page 10**.

Background and Statutory responsibilities

This document supplements our Audit Fee Letter 2015/16 presented to you in April 2015, which also sets out details of our appointment by Public Sector Audit Appointments Ltd (PSAA).

Our statutory responsibilities and powers are set out in the Local Audit and Accountability Act 2014 and the National Audit Office's Code of Audit Practice.

Our audit has two key 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 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.

Acknowledgements

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

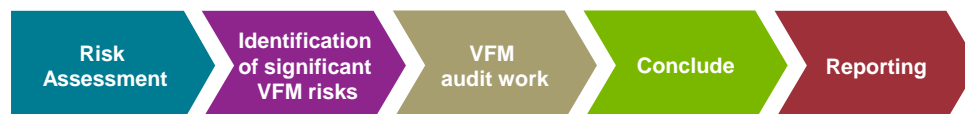
Financial Statements Audit

Our financial statements audit work follows a four stage audit process which is identified below. Appendix 1 provides more detail on the activities that this includes. This report concentrates on the Financial Statements Audit Planning stage of the Financial Statements Audit.



Value for Money Arrangements Work

Our Value for Money (VFM) Arrangements Work follows a five stage process which is identified below. Page 6 provides more detail on the activities that this includes. This report concentrates on explaining the VFM approach for the 2015/16 [and the findings of our VFM risk assessment].



Financial Statements Audit Planning

Our planning work takes place during December and January. This involves the following key aspects:

- Risk assessment;
- Determining our materiality level; and
- Issuing this audit plan to communicate our audit strategy.

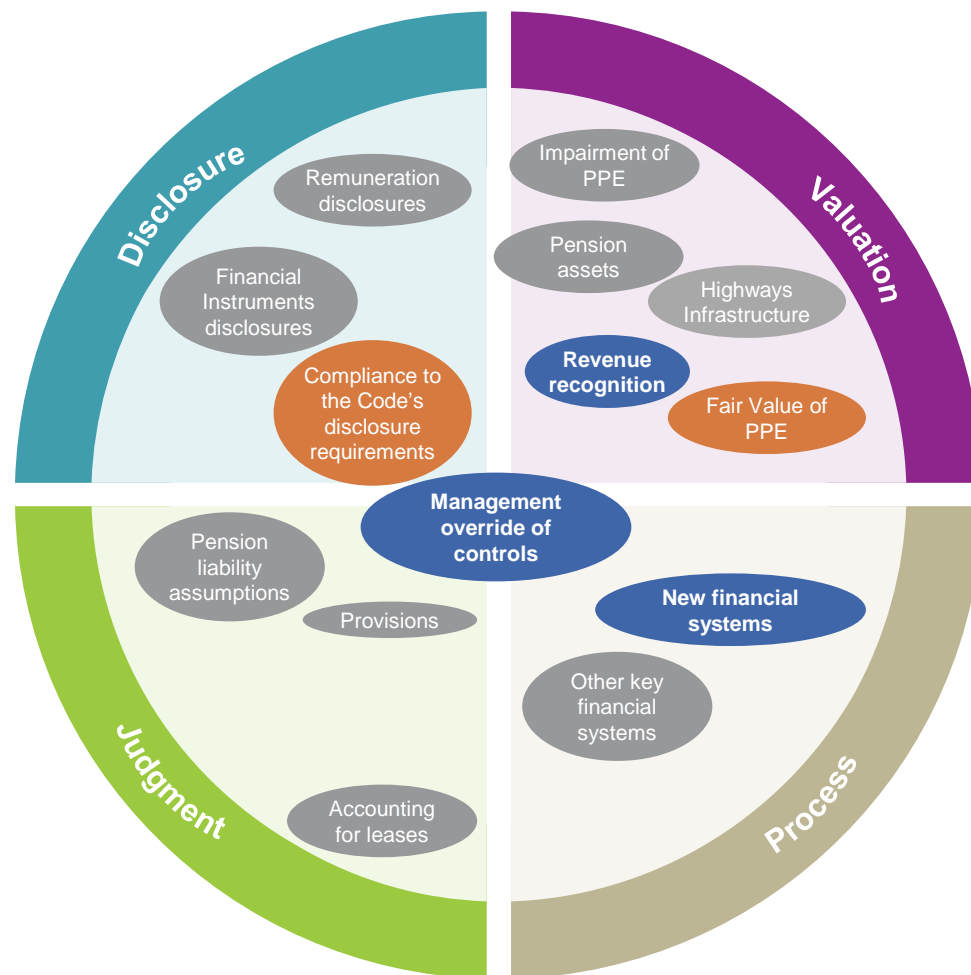
Risk assessment

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.

The diagram opposite identifies, significant risks and other areas of audit focus, which we expand on overleaf. The diagram also identifies a range of other areas considered by our audit approach.



Keys: ● Significant risk ● Other area of audit focus ● Example other areas considered by our approach

Significant Audit Risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error.

Authority and Pension Fund Accounts - Change to financial systems

Risk

In April 2015 the Authority changed, under the new support services contract with Serco, its corporate financial system with SAP being replaced by Agresso. The Authority has reported significant issues with the operation of the Agresso system throughout the year, including major difficulties in:

- accurately processing the monthly payrolls;
- making timely and accurate payments through the accounts payable procedures; and
- accounting for transactions, and monitoring and reporting its financial performance due to problems with the operation of the general ledger.

The Authority has been working with Serco throughout the year to establish effective controls to ensure there is a fully operational system platform and resolve historical processing errors. This work is still in progress.

The weaknesses in the system controls and financial reporting arrangements in the year represent a significant audit risk.

Approach

We have monitored throughout the year the Authority's progress in addressing the issues with Agresso. We will review the arrangements and controls put in place in greater detail at the interim audit visit. We will also discuss with managers their plans for addressing the continuing difficulties with the operation of the general ledger and correcting the accounting errors in the year. We will then update our detailed testing strategy, and work with officers to agree the timing of the programme of testing and the information required. The known difficulties with Agresso means that our approach this year will be largely substantive rather than controls based testing. The issues with Agresso, and the required audit response, will impact on the timing of our audit work and volume of audit testing required to obtain the assurances we require. We will keep the Audit Committee informed on progress and the impact on the audit fee.

Pension Fund Accounts - Change to pensions administration services provider

Risk

In April 2015 the Lincolnshire Pension Fund's support services provider for pension administration changed from Mouchel to West Yorkshire Pensions. There have been changes to the systems and procedures in place to support the arrangements for processing and accounting for pensioners' contributions and payments of pension. These amounts are material to the Pension Fund accounts.

Approach

We will review at our interim visit the processes and controls in place for the operation of the new pensions administration arrangements and agree with officers the information required for our detailed testing strategy. The additional audit work required as a result of the change to the arrangements is likely to impact on the audit fee. We will update Audit Committee as the audit progresses.

Other areas of audit focus

Other areas of audit focus are those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding. We will review and discuss with officers the changes to the accounts required by this year's CIPFA Code of Accounting Practice, which include:

- changes to the valuation of surplus assets
- the replacement of the Explanatory Foreword with the Narrative Statement

We will also review and discuss with officers the disclosure and accounting arrangements for the Better Care Fund, which the Authority hosts on behalf of the Lincolnshire health and local government bodies. We will update the Audit Committee during the year if any new issues emerge.

Materiality

We are required to plan our audit to determine with reasonable confidence whether or not the financial statements are free from material misstatement. An omission or misstatement is regarded as material if it would reasonably influence the user of financial statements. This therefore involves an assessment of the qualitative and quantitative nature of omissions and misstatements.

Generally, we would not consider differences in opinion in respect of areas of judgement to represent 'misstatements' unless the application of that judgement results in a financial amount falling outside of a range which we consider to be acceptable.

For the Authority, materiality for planning purposes has been set at £12m which equates to little over 1% of prior year's gross expenditure.

For the Pension Fund, materiality for planning purposes has been set at £16m, which equates to 1% of forecast assets.

We design our procedures to detect errors in specific accounts at a lower level of precision. For planning purposes this lower threshold has been set at £8m for the Authority and £10m for the Pension Fund

Reporting to the Audit Committee

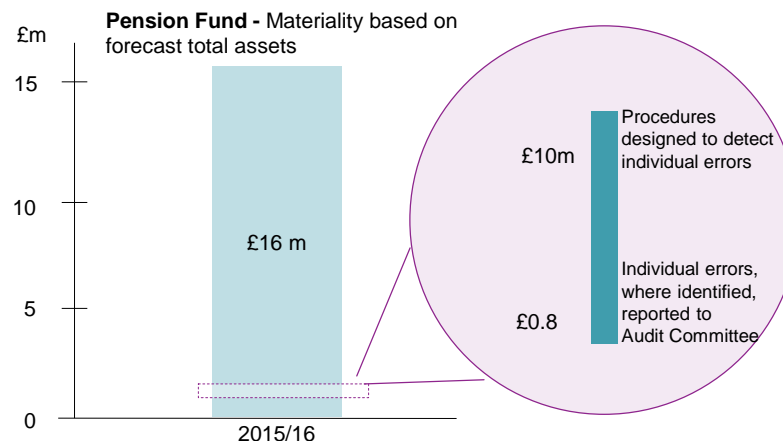
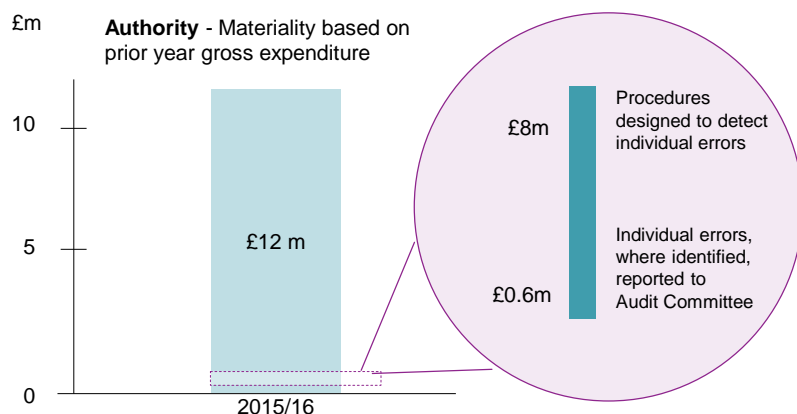
Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work.

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.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £0.6m.

In the context of the Pension Fund, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £0.8m.

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.

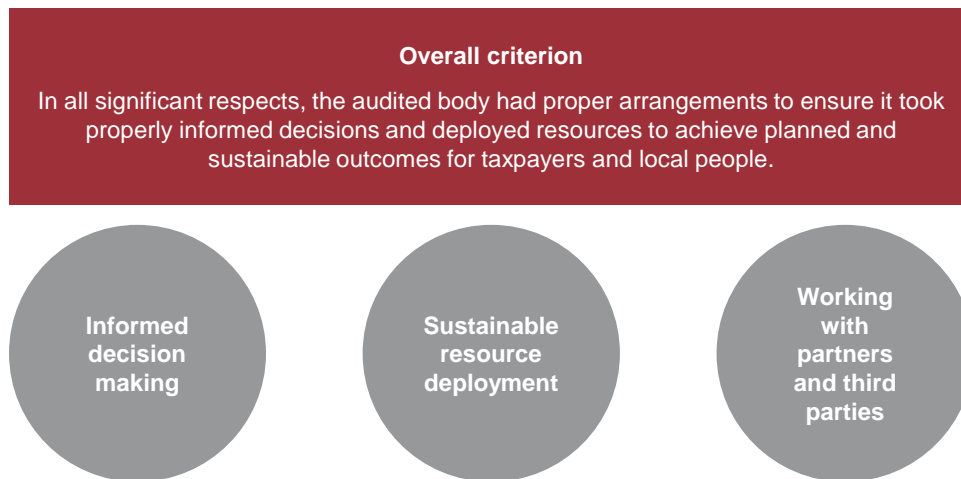


Background to approach to VFM work

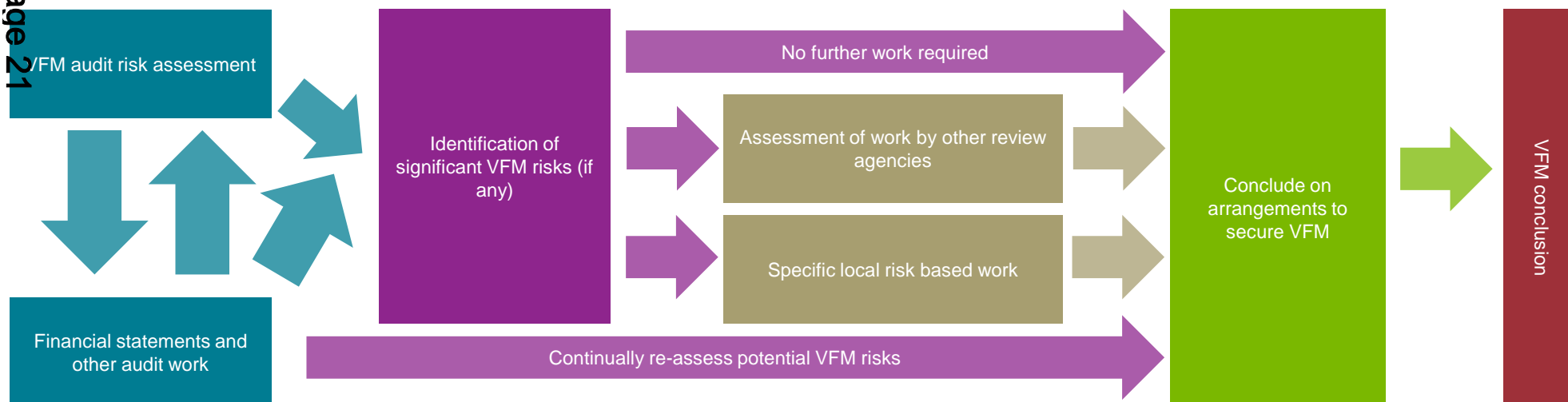
The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

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

The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria. These sub-criteria provide a focus to our VFM work at the Authority. The diagram to the right shows the details of this criteria.



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VFM audit stage	Audit approach
VFM audit risk assessment	<p>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 <i>Code of Audit Practice</i>.</p> <p>In doing so we consider:</p> <ul style="list-style-type: none"> ■ The Authority's own assessment of the risks it faces, and its arrangements to manage and address its risks; ■ Information from the Public Sector Auditor Appointments Limited VFM profile tool; ■ Evidence gained from previous audit work, including the response to that work; and ■ The work of other inspectorates and review agencies.
Linkages with financial statements and other audit work	<p>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.</p> <p>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.</p>
Identification of significant risks	<p>The Code identifies a matter as significant 'if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public. Significance has both qualitative and quantitative aspects.'</p> <p>If we identify significant VFM risks, then we will highlight the risk to the Authority and consider the most appropriate audit response in each case, including:</p> <ul style="list-style-type: none"> ■ 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 stage	Audit approach
<p>Assessment of work by other review agencies</p> <p>and</p> <p>Delivery of local risk based work</p>	<p>Depending on the nature of the significant VFM risk identified, we may be able to draw on the work of other inspectorates, review agencies and other relevant bodies to provide us with the necessary evidence to reach our conclusion on the risk.</p> <p>If such evidence is not available, we will instead need to consider what additional work we will be required to undertake to satisfy ourselves that we have reasonable evidence to support the conclusion that we will draw. Such work may include:</p> <ul style="list-style-type: none"> ■ Meeting with senior managers across the Authority; ■ Review of minutes and internal reports; ■ Examination of financial models for reasonableness, using our own experience and benchmarking data from within and without the sector.
<p>Concluding on VFM arrangements</p>	<p>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.</p> <p>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.</p>
<p>Reporting</p>	<p>On the following page, we report the results of our initial risk assessment.</p> <p>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.</p> <p>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.</p>

Significant VFM Risks

Those risks requiring specific audit attention and procedures to address the likelihood that proper arrangements are not in place to deliver value for money.

Operation of Serco Support Services Contract

Risk

The contract with Serco has not operated effectively during the year. The contract programme board arrangements have continued beyond the planned end of June 2015 and there is a Recovery Board in place. Progress is reported as being made in relation to the continuing areas of concern but the pace of improvement has been slow. The direct cost to the Authority of the continuing issues is being mitigated by it withholding contractual payments and seeking recovery of additional costs it has incurred. The issues continue though to be a significant pressure on management and staff.

Approach

We will monitor your progress in addressing the continuing issues with the operation of the contract with Serco. We will update our risk assessment during the year and report our conclusions in the ISA260 report to the Audit Committee in September 2016.

Managing your budget and shaping your medium term financial strategy

Risk

The difficulties in operating the Agresso system have meant that the Authority has not been able to fully monitor and report on spend against budgets throughout the year using its core corporate financial systems. Some significant areas of expenditure, such as payroll, were not fully loaded into the general ledger for much of the year. The Authority has where necessary used 'off-line' processes to get assurance that spending is not out of control (for example cash flow monitoring against forecasts, local stand-alone monitoring spreadsheet records, and activity monitoring using the separate care systems for Adults and 'looked after children'). The Authority also continues to face significant medium term financial and operational risks and is working to prepare a balanced and sustainable budget for 2017 onwards.

Approach

We will:

- Assess your arrangements for ensuring effective budget management and control and review your progress in implementing the expected Agresso system controls.
- Discuss with management the Authority's progress in managing its medium term financial position.

We will report our conclusions in the ISA260 report to the Audit Committee in September 2016.

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 approach for 2015/16 have not yet been confirmed.

Elector challenge

The Local Audit and Accountability Act 2014 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 PSAA's fee scales.

Our audit team

Our audit team will be led by John Cornett, who is your new Director on the audit. Mike Norman will continue as your Manager on the audit and John Pressley will provide Assistant Manager support. Appendix 2 provides more details on specific roles and contact details of the team.

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 communication outputs are included in Appendix 1.

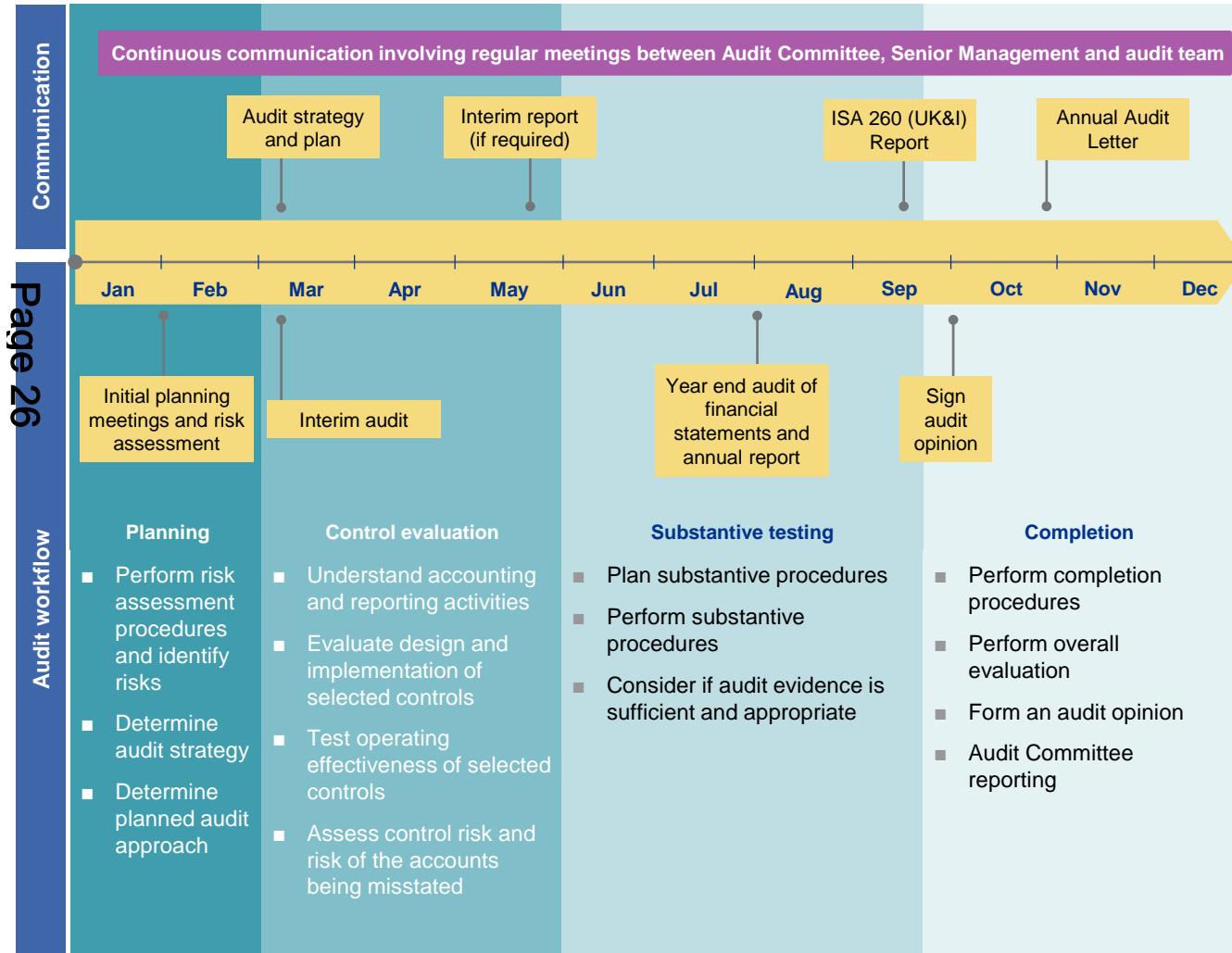
Independence and Objectivity

Auditors are also required to be independent and objective. Appendix 3 provides more details of our confirmation of independence and objectivity.

Audit fee

Our Audit Fee Letter 2015/16 presented to you in April 2015 first set out our fees for the 2015/16 audit of the Authority and Pension Fund. This letter also set out our assumptions on which that fee was based. We have highlighted in this plan a number of audit risks and other factors which are likely to require us to carry out additional work in support of our audit opinions and value for money conclusion.

The scale audit fee for 2015/16 is £107,325 for the Authority. This is a reduction in audit fee, compared to 2014/2015, of £35,775 (25%). The scale audit fee for 2015/16 is £24,350 for the Pension Fund. (2014/15 £24,350). We will keep you informed if the any increase to the scale fee is likely to be required. Any increase would in any case be subject to the approval of the PSAA.



We have highlighted risks in this plan regarding the weaknesses in the operation of the Agresso system and the potential impact of these issues on the Authority's closedown and accounts production arrangements.

The main visit to complete the audit of the draft financial statements has been provisionally scheduled to start in late July 2016. This is later than we would normally start the work to allow the authority, should it need it, additional time to finalise its financial statements and supporting working papers.

We have planned the audit with an expectation that the Authority will be able to provide the evidence necessary to support its financial statements and respond to any audit queries in time to enable us to report to the Audit Committee and give an audit opinion before 30 September 2016.

We will keep the Audit Committee informed on the progress on the audit and advise if the audit opinion is likely to be issued after 30 September 2016.

Your audit team has been drawn from our specialist public sector assurance department and includes continuity from last year's audit.



Name	John Cornett
Position	Director
	<p>'My role is to lead our team and ensure the delivery of a high quality, valued added external audit opinion.</p> <p>I will be the main point of contact for the Audit Committee, Chief Executive and Strategic Directors.'</p>

John Cornett

Director

07468749927

john.cornett@kpmg.co.uk



Name	Mike Norman
Position	Manager
	<p>I will continue to be responsible for the management, review and delivery of the audit of the Authority and Pension Fund.</p> <p>I will liaise with the County Finance Officer and the Audit and Risk Manager."</p>

Mike Norman

Manager

07500125105

Michael.norman@kpmg.co.uk



Name	John Pressley
Position	Assistant Manager
	<p>"I acted as 'in-charge' for the Pension Fund audit last year. I will be responsible for the on-site delivery of our work on the Authority's financial statements and the Pension Fund this year. I will liaise with the Finance Team. I will also supervise the work of our audit assistants."</p>

John Pressley

Assistant Manager

07919697377

John.Pressley@kpmg.co.uk

Independence and objectivity

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.

Further to this auditors are required by the National Audit Office's Code of Audit Practice to:

- Carry out their work with integrity, independence and objectivity;
- Be transparent and report publicly as required;
- Be professional and proportional in conducting work;
- Be mindful of the activities of inspectorates to prevent duplication;
- Take a constructive and positive approach to their work;
- Comply with data statutory and other relevant requirements relating to the security, transfer, holding, disclosure and disposal of information.

PSAA's Terms of Appointment 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 PSAA audit work 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.
- Auditors appointed by the PSAA should not accept engagements which involve commenting on the performance of other PSAA auditors on PSAA work without first consulting PSAA.
- Auditors are expected to comply with the Terms of Appointment policy for the Engagement Lead to be changed on a periodic basis.
- Audit suppliers are required to obtain the PSAA'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 Terms of Appointment.

Confirmation statement

We confirm that as of March 2016 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.



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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. We draw your attention to the Statement of Responsibilities of auditors and audited bodies, which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

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

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

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