

Annual Audit Letter

Lincolnshire County Council

Year ending 31 March 2019





CONTENTS

1. Executive summary
2. Audit of the financial statements
3. Value for Money conclusion
4. Other reporting responsibilities
5. Our fees
6. Forward look

Our reports are prepared in the context of the 'Statement of responsibilities of auditors and audited bodies' issued by Public Sector Audit Appointments Ltd. Reports and letters prepared by appointed auditors and addressed to members or officers are prepared for the sole use of the Council and we take no responsibility to any member or officer in their individual capacity or to any third party.

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1. EXECUTIVE SUMMARY

Purpose of the Annual Audit Letter

Our Annual Audit Letter summarises the work we have undertaken as the auditor for Lincolnshire County Council for the year ended 31 March 2019. Although this letter is addressed to the Council, it is designed to be read by a wider audience including members of the public and other external stakeholders.

Our responsibilities are defined by the Local Audit and Accountability Act 2014 (the 2014 Act) and the Code of Audit Practice issued by the National Audit Office (the NAO). The detailed sections of this letter provide details on those responsibilities, the work we have done to discharge them, and the key findings arising from our work. These are summarised below.

Area of responsibility	Summary
Audit of the financial statements	<p>Our auditor's report issued on 31 July 2019 included our opinion that the financial statements:</p> <ul style="list-style-type: none">• give a true and fair view of the Council's financial position as at 31 March 2019 and of its expenditure and income for the year then ended; and• have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.
Other information published alongside the audited financial statements	<p>Our auditor's report issued on 31 July 2019 included our opinion that the other information in the Statement of Accounts is consistent with the audited financial statements.</p>
Value for Money conclusion	<p>Our auditor's report concluded that we are satisfied that in all significant respects, the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.</p>
Reporting to the group auditor	<p>In line with group audit instructions issued by the NAO, on 30 August 2019 we reported to the group auditor in line with the requirements applicable to the Council's WGA return.</p>
Statutory reporting	<p>Our auditor's report confirmed that we did not use our powers under s24 of the 2014 Act to issue a report in the public interest or to make written recommendations to the Council.</p> <p>We issued our Audit Certificate on 9 September 2019, which confirmed the completion of the audit in accordance with the 2014 Act and the Code of Audit Practice.</p>

2. AUDIT OF THE FINANCIAL STATEMENTS

Opinion on the financial statements

Unqualified

The scope of our audit and the results of our work

The purpose of our audit is to provide reasonable assurance to users that the financial statements are free from material error. We do this by expressing an opinion on whether the statements are prepared, in all material respects, in line with the financial reporting framework applicable to the Council and whether they give a true and fair view of the Council's financial position as at 31 March 2019 and of its financial performance for the year then ended.

Our audit was conducted in accordance with the requirements of the Code of Audit Practice issued by the NAO, and International Standards on Auditing (ISAs). These require us to consider whether:

- the accounting policies are appropriate to the Council's circumstances and have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management in the preparation of the financial statements are reasonable; and
- the overall presentation of the financial statements provides a true and fair view.

Our auditor's report, issued to the Council on 31 July 2019, stated that, in our view, the financial statements give a true and fair view of the Council's financial position as at 31 March 2019 and of its financial performance for the year then ended.

Our approach to materiality

We apply the concept of materiality when planning and performing our audit, and when evaluating the effect of misstatements identified as part of our work. We consider the concept of materiality at numerous stages throughout the audit process, in particular when determining the nature, timing and extent of our audit procedures, and when evaluating the effect of uncorrected misstatements. An item is considered material if its misstatement or omission could reasonably be expected to influence the economic decisions of users of the financial statements.

Judgements about materiality are made in the light of surrounding circumstances and are affected by both qualitative and quantitative factors. As a result we have set materiality for the financial statements as a whole (financial statement materiality) and a lower level of materiality for specific items of account (specific materiality) due to the nature of these items or because they attract public interest. We also set a threshold for reporting identified misstatements to the Audit Committee. We call this our trivial threshold.

The table below provides details of the materiality levels applied in the audit of the financial statements for the year ended 31 March 2019:

Financial statement materiality	Our financial statement materiality is based on 2% of Gross Revenue Expenditure at a Surplus/Deficit on Provision of Services level	£22.1m
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	£663k
Specific materiality	We have applied a lower level of materiality to the following areas of the accounts: - Officers remuneration (bandings) - Members allowances - Audit Fees	£5k £248k £21k

2. AUDIT OF THE FINANCIAL STATEMENTS

Our response to significant risks

As part of our continuous planning procedures we considered whether there were risks of material misstatement in the Council's financial statements that required special audit consideration. We reported significant risks identified at the planning stage to the Audit Committee within the Audit Strategy Memorandum and provided details of how we responded to those risks in our Audit Completion Report. The table below outlines the identified significant risks, the work we carried out on those risks and our conclusions.

Identified significant risk	Our response	Our findings and conclusions
<p>Management override of controls</p> <p>Management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur there is a risk of material misstatement due to fraud on all audits.</p>	<p>We addressed this risk by:</p> <ul style="list-style-type: none"> • Documenting our understanding of the processes and controls in place to mitigate the risks identified, and walk through those processes and controls to confirm our understanding; • Testing the appropriateness of journal entries recorded in the general ledger and other material adjustments made in the preparation of the financial statements; • Evaluating the business rationale for any significant transactions outside the course of the business; • Understanding the oversight given by those charged with governance of management process over fraud; • Making enquiries of management and Internal Audit regarding actual or any suspicions of fraud; and • Considering whether the Council's accounting policies are consistent with industry standards. 	<p>There are no matters arising from our work that we need to report to you.</p>
<p>Expenditure Recognition</p> <p>Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. Practice Note 10 issued by the Financial Reporting Council states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition</p> <p>Having considered the factors for expenditure recognition, we determined that the risk was focused on the year-end balance sheet and in particular the completeness and valuation of payables, specifically those that are material and manually accrued.</p>	<p>We addressed this risk by:</p> <ul style="list-style-type: none"> • Ensuring the accounting policies in relation to expenditure recognition and recognition of accruals were appropriate and consistently applied. • Testing year end manual expenditure accruals to confirm that they had been correctly valued and categorized and correctly treated as a creditor of the authority. • Carrying out cut-off testing, and testing for unrecorded liabilities, to confirm expenditure had been coded to the correct accounting year. 	<p>There are no matters arising from our work that we need to report to you.</p>

2. AUDIT OF THE FINANCIAL STATEMENTS

Identified significant risk	Our response	Our findings and conclusions
<p>Revenue recognition</p> <p>Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. Having considered the factors for revenue recognition, we determined that the risk was focused on the year-end balance sheet and in particular the existence and accuracy of receivables, specifically those that are material, subject to manual intervention and/or significant estimation.</p>	<p>We addressed this risk by:</p> <ul style="list-style-type: none"> • Ensuring the accounting policies in relation to revenue recognition and recognition of accruals were appropriate and consistently applied. • Testing year end manual income accruals to confirm that they had been correctly valued and categorized and correctly treated as a debtor of the authority. • Carrying out cut-off testing to confirm income had been coded to the correct accounting year. 	<p>There are no matters arising from our work that we need to report to you.</p>
<p>Valuation of property, plant and equipment (PPE) and investment properties</p> <p>The Council employs a valuation expert to provide information on revaluations, however there remains a high degree of estimation uncertainty associated with the revaluations of PPE and investment properties due to the significant judgements and number of variables involved.</p>	<p>We addressed this risk by:</p> <ul style="list-style-type: none"> • Testing a sample of assets valued during the year to valuation reports; • Where material, testing the basis for impairment of assets, the value and correct accounting treatment; • Critically assessing the Council's valuers' scope of work and methodology used for a sample of valuations; and • Considering the impact of any assets not valued during the year. 	<p>We were satisfied the estimates were reasonable and materially correct.</p>
<p>Valuation of defined benefit pension net liability</p> <p>The Council's accounts contain material liabilities relating to the Local Government Pension Scheme (LGPS). The Council uses an actuary to provide an annual valuation of these liabilities in line with the requirements of IAS 19 Employee Benefits. Due to the high degree of estimation uncertainty associated with this valuation, we have determined there is a significant risk in this area.</p>	<p>We addressed this risk by:</p> <ul style="list-style-type: none"> • Reviewing the appropriateness of the Pension Asset and Liability valuation methodologies applied by the Pension Fund Actuary, and the key assumptions included within the valuation. We compared these to expected ranges, utilising information provided by PWC, the consulting actuary engaged by the NAO; • Agreeing the data in the IAS 19 valuation reports provided by the Fund's Actuary for accounting purposes to the pension accounting entries and disclosures in the Council's financial statements; • Assessing the competency, objectivity and independence of the Fund's Actuary; and • Liaising with the Pension Fund auditors to gain assurance that the controls in place at the Fund were operating effectively, and to confirm that the data provided to the Actuary by the Fund for the purposes of the IAS 19 valuation was complete and accurate. 	<p>The Council obtained an updated IAS19 valuation report from the Actuary in July 2019, to take into account: the implications of the GMP and McCloud judgments, which impacted on the estimated pension liabilities and had not been taken into account by the Actuary in their original report.</p> <p>The report included material differences to the original report used to prepare the draft financial statements. Management amended the draft financial statements for these differences.</p> <p>We were satisfied that the final estimates included in the financial statements were reasonable and materially correct.</p>

2. AUDIT OF THE FINANCIAL STATEMENTS

Internal control recommendations

As part of our audit we considered the internal controls in place that are relevant to the preparation of the financial statements. We did this to design audit procedures that allow us to express our opinion on the financial statements, but this did not extend to us expressing an opinion on the effectiveness of internal controls. The matters we report are limited to those deficiencies and other control recommendations that we have identified during our normal audit procedures and that we consider to be of sufficient importance to merit being reported. We have not identified any significant control deficiencies that we are required to report to you.

3. VALUE FOR MONEY CONCLUSION

Value for Money conclusion

Unqualified

Our approach to Value for Money

We are required to consider whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The NAO issues guidance to auditors that underpins the work we are required to carry out in order to form our conclusion, and sets out the criterion and sub-criteria that we are required to consider.

The overall criterion is that, 'in all significant respects, the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.' To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria are set out by the NAO:

- Informed decision making
- Sustainable resource deployment
- Working with partners and other third parties

Our auditor's report, issued to the Council on 31 July 2019, stated that, in all significant respects, the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31st March 2019.

Significant Value for Money risks

The NAO's guidance requires us to carry out work to identify whether or not a risk to the Value for Money conclusion exists. Risk, in the context of our Value for Money work, is the risk that we come to an incorrect conclusion rather than the risk of the arrangements in place at the Council being inadequate. In our Audit Completion Report we reported that we had not identified any significant Value for Money risks but we set out one area which we would keep under review:

- Financial sustainability – In 2018 the Council published a two year balanced budget, having previously only published a one year plan. The original budgets included use of reserves (£5.9m in 2018/19 and £34.2m in 2019/20), including the Financial Volatility reserve set aside for this purpose. The current plan takes the Council to the end of the period covered by the 4 year grant settlement agreed with central government. The 2020/21 onwards financial position is uncertain, which is a common issue for all bodies in the local government sector and the forecast service demands and funding assumptions indicate a likely shortfall in those years. The Council is revisiting its budget and developing proposals to bridge the gap. We need to monitor the progress made and revisit position in relation to this significant risk before forming our VFM conclusion.

Before drawing our conclusion we:

- Reviewed the 2018/19 financial performance and forecasts during the year and considered the Council's financial outturn position as presented in the financial statements.
- Reviewed the 2019/20:
 - Revenue and Capital budgets and Medium Term Financial Plan
 - Treasury Management Strategy, incorporating the Minimum Revenue Provision Policy and Capital and Investment Strategies
- Considered the Council's latest financial monitoring information and medium term outlook and the budget review programme arrangements established to set the 2020/21 budget and updated medium term financial plan.

We found that the outturn presented to the Council's Overview & Scrutiny Board in June 2019 showed a £15m underspend excluding schools and £0.5m use of reserves. The Council's Financial Volatility reserve was increased with a £10m contribution from the underspend. This position demonstrated the Council's ability to deliver in-year financial performance within planned control measures, including the delivery of savings and services in line with plan. The updated medium term financial plan includes a risk assessment on key assumptions and is aligned to the Council's plans. Further work is required to identify specific savings plans for 2020/21 and beyond. There is a recognition by management that the budget and MTFP need to be repositioned to manage the impact on reserves and a range of formal and strengthened budget review arrangements are in place in 2019/20 for this purpose.

1. Executive summary

2. Audit of the financial statements

3. Value for Money conclusion

4. Other reporting responsibilities

5. Our fees

6. Forward look

4. OTHER REPORTING RESPONSIBILITIES

Exercise of statutory reporting powers	No matters to report
Reporting to the NAO in respect of Whole of Government Accounts consolidation data	Assurance Statement submitted
Other information published alongside the audited financial statements	Consistent

The NAO's Code of Audit Practice and the 2014 Act place wider reporting responsibilities on us, as the Council's external auditor. We set out below, the context of these reporting responsibilities and our findings for each.

Matters on which we report by exception

The 2014 Act provides us with specific powers where matters come to our attention that, in our judgement, require reporting action to be taken. We have the power to:

- Issue a report in the public interest;
- make statutory recommendations that must be considered and responded to publicly;
- apply to the court for a declaration that an item of account is contrary to law; and
- issue an advisory notice under schedule 8 of the 2014 Act.

We have not exercised any of these statutory reporting powers.

The 2014 Act also gives rights to local electors and other parties, such as the right to ask questions of the auditor and the right to make an objection to an item of account. We did not receive any such objections or questions.

Reporting to the NAO in respect of Whole of Government Accounts consolidation data

The NAO, as group auditor, requires us to complete a programme of audit work before providing our WGA Assurance Statement in respect of the Council's consolidation data return. We completed the audit programme and agreed a small number of changes to the data return. We submitted our consistency report and the other information required to the NAO on 30 August 2019.

Other information published alongside the financial statements

The Code of Audit Practice requires us to consider whether information published alongside the financial statements is consistent with those statements and our knowledge and understanding of the Council. In our opinion, the other information in the Statement of Accounts is consistent with the audited financial statements.

5. OUR FEES

Fees for work as the Council's auditor

We reported our proposed fees for the delivery of our work in the Audit Strategy Memorandum, presented to the Audit Committee in April 2019.

We have completed our work for the 2018/19 financial year, including the additional work required relating to the material amendments to the Pension estimates included in the Financial Statements and the prior period restatements as described at page 5. The final fee for the audit has not been confirmed yet and is then subject to PSAA approval. The fee for the Code of Practice audit is summarised in the table below:

Area of work	2018/19 proposed fee	2018/19 final fee*
Delivery of audit work under the NAO Code of Audit Practice	£82,640	£82,640*

* the final fee for the 2018/19 audit has not been confirmed yet and is then subject to PSAA approval.

Fees for other work

The fees for the other work the Council engaged us to carry out in the year are summarised in the table below:

Area of work	Fee
Reporting Accountant's Independent Assurance Report - Local Transport Plan Major Projects S31 AUD Return (Lincolnshire County Council Lincoln Eastern Bypass) for the year ended 31 March 2018 (December 2018)	£6,500
Education & Skills Funding Agency 2018/19 - external assurance on subcontracting systems and controls (July 2019)	£5,250

6. FORWARD LOOK

Audit Developments

Code of Audit Practice

The Code of Audit Practice sets out what local auditors of relevant local public bodies are required to do to fulfil their statutory responsibilities under the Local Audit and Accountability Act 2014. We have responded to the National Audit Office's consultation on the content of the Code (<https://www.nao.org.uk/code-audit-practice/about-code/>)

A new Code will be laid in Parliament in time for it to come in to force no later than 1 April 2020.

Financial Resilience

Fair Funding Review

The Council will need to incorporate the outcome of the Spending Review, due in the latter half of 2019, into its Medium Term Financial Plan. The Spending Review will set out the department allocations for 2020/21 and potentially beyond. Regardless of the timing and period covered by the Spending Review, the Council recognises the key issue is the management of general reserves to a level that ensures it remains financially resilient and able to deliver sustainable services. It must, therefore, ensure it clarifies and quantifies how it will bridge the funding gap through planned expenditure reductions and/ or income generation schemes.

Local Authority Financial Resilience Index

CIPFA is moving forward with its financial resilience index, which it believes will be a barometer on which local authorities will be judged. We would expect the Council to have at least considered the index once it is formally released.

Commercialisation

The National Audit Office will be publishing a report on Commercialisation during 2019. Depending on the Council's appetite for Commercialisation, we would expect the Council to consider the outcome of the report and ensure any lessons learnt are incorporated into business practice.

Further, the UK Debt Management Office's Annual Report, published on 23 July 2019, reported that, as at 31 March 2019, the Public Works Loan Board's loan book was £78.3 billion with 1,308 new loans totalling £9.1 billion advanced during the year. As a result, we expect local authorities to clearly demonstrate:

- the value for money in the use of Public Works Loan Board funds to acquire commercial property
- the arrangements for loan repayment through the updated Statutory Guidance on Minimum Revenue Provision in 2019/20, 2020/21 and beyond.

Financial Reporting

UK Local Government Annual Accounts

The CIPFA/LASAAC Local Authority Code Board specifies the financial reporting requirements for UK local government. A consultation is underway to inform the direction and strategy for local government annual accounts. We will be submitting our response and suggest practitioners also voice their opinion.

Lease accounting

The implementation of IFRS 16 Leases in the Code is delayed until 1 April 2020. The Council will need a project plan to ensure the data analysis and evaluation of accounting entries is completed in good time to ensure any changes in both business practice and financial reporting are captured.

6. FORWARD LOOK

Financial outlook

It is clear that the Council faces some of the most difficult decisions it has ever faced in balancing the budget going forwards. Although the Council does have reserves available to minimise the immediate impact these are a temporary or transitional cushion while the savings needed are identified and delivered.

In addition, the reserves available to support the budget are reducing and the available balances will soon reach the minimum needed to deal with unforeseen circumstances and risk, and will not be available to support the revenue budget in the way that they have in recent years. The key message from those councils that have already faced a financial crisis, such as Northamptonshire and others, is the importance of taking early action to secure financial sustainability before the position becomes unmanageable.

The position beyond 2019/20 is very uncertain as much depends on the outcome of the comprehensive spending review, fair funding review and the measures that will be taken in relation to the future operation of the business rates system. However, it seems unlikely that the overall financial position for the Council will improve sufficiently to allow it to defer any of the difficult decisions that are now needed.

Decisive action to bridge the budget gap over the medium term is a key priority for the Council.

How we will work with the Authority

We will focus our work on the risks that your challenges present to your financial statements and your ability to maintain proper arrangements for securing value for money.

In the coming year we will continue to support the Council by:

- continued liaison with the Council's Internal Auditors to minimise duplication of work;
- attending Audit Committee meetings and presenting an Audit Progress Report including updates on regional and national developments; and
- hosting events for staff, such as our Local Government Accounts workshop.

We will meet with key Council officers to identify any learning from the 2018/19 audit and will continue to share our insights from across local government and relevant knowledge from the wider public and private sector.

In terms of the technical challenges that officers face around the production of the statement of accounts, we will continue to work with them to share our knowledge of new accounting developments and we will be on hand to discuss any issues as and when they arise.

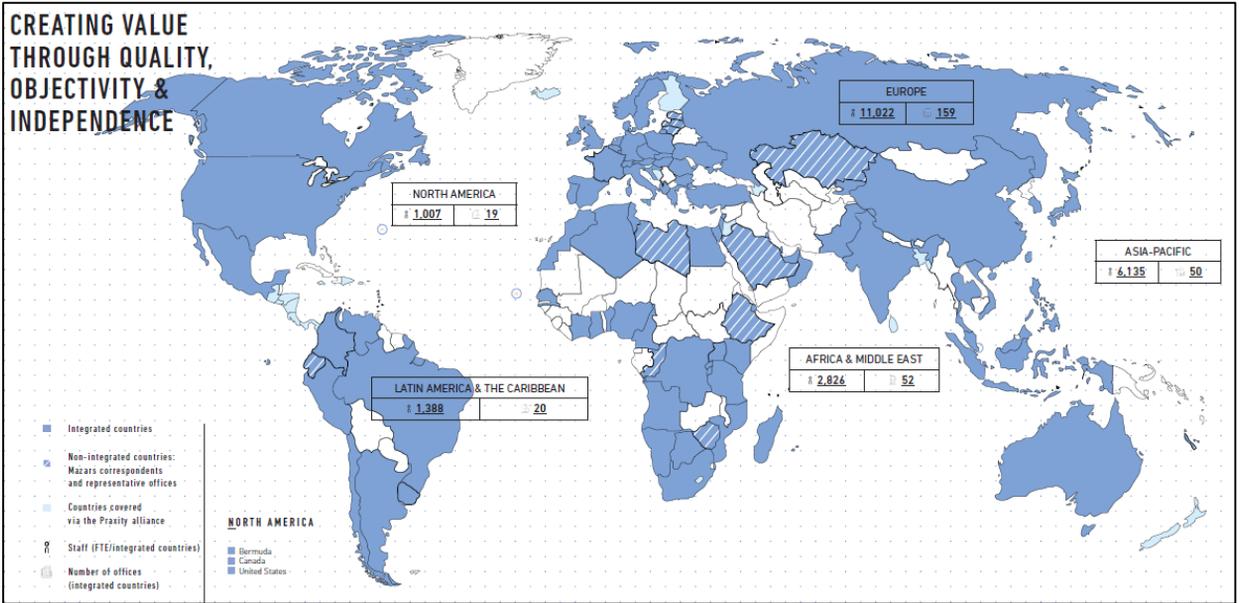
The Council has taken a positive and constructive approach to our audit and we wish to thank Members and officers for their support and co-operation during our audit.

MAZARS AT A GLANCE

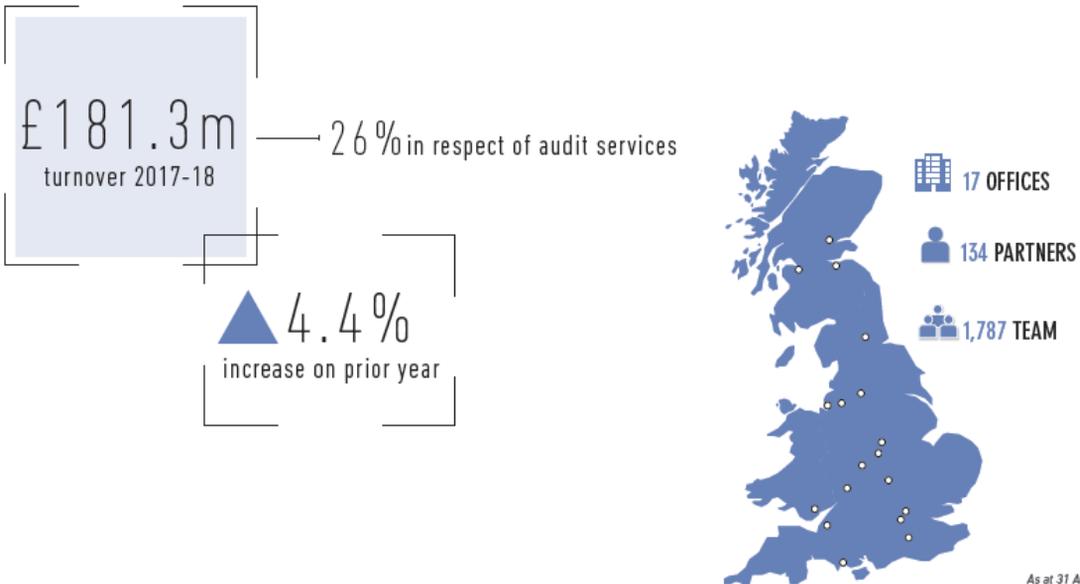
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