Appendix A

KPMG

External Audit ISA260 Report 2017/18 DRAFT

Lancaster City Council

—

July 2018

Summary for Audit Committee

This document summarises the key findings in relation to our 2017-18 external audit at Lancaster City Council ('the Authority').

This report covers both our on-site work which was completed in March and June 2018 on the Authority's significant risk areas, as well as other areas of your financial statements, and the control environment in place to support the production of timely and accurate financial statements.

Financial statements

Subject to all outstanding queries being resolved to our satisfaction we anticipate issuing an unqualified audit opinion on the Authority's financial statements before the deadline of 31 July 2018. These outstanding items include:

- **Completion of audit work on pensions, staff costs and journals.**
- **Final procedures regarding the allocation of pension fund assets;**
- **Final review of the financial statements, including the adjustment in respect of pension deficit contributions;**
- **Finalisation of queries relating to PPE valuation;**
- **Receipt of the management representation letter; and**
- **Completion of our Whole of Government Account work, which does not prevent us from issuing our audit opinion on the financial statements.**

Based upon our initial assessment of risks to the financial statements (as reported to you in our *External Audit Plan 2017/18* and updated during our audit) we identified the following significant risks (excluding those mandated by International Standards on Auditing – see Page 8):

- **Valuation of PPE** – Whilst the Authority operates a cyclical revaluation approach, the Code requires that all land and buildings be held at fair value. We considered the way in which the Authority ensures that assets not subject to in-year revaluation are not materially misstated. We have not identified any material misstatements arising from this significant risk for 2017/18.
- **Pensions Liabilities** – The valuation of the Authority's net pension liability, as calculated by the Actuary, is dependent upon both the accuracy and completeness of the data provided and the assumptions adopted. We reviewed the processes in place to ensure accuracy of data provided to the Actuary and considered the assumptions used in determining the valuation. We have identified an adjustment relating to the treatment of the pension deficit contributions at Appendix 2.

We have identified one audit adjustment with a total value of £7.9 million. See pages 13 and 23 for details. These adjustments result in a net decrease of £1.9 million in the reported deficit on provision of services, but no impact on the General Fund balance.

We are now in the completion stage of the audit and anticipate being able to issue our completion certificate and Annual Audit letter by 31 July 2018.

Summary for Audit Committee (cont.)

Value for money arrangements

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

We therefore anticipate issuing an unqualified value for money opinion.

We set out our assessment of those areas requiring additional risk based work in our *External Audit Plan 2017/18* and have updated this assessment during our interim visit. As a result of this we have identified the following significant VFM audit risk:

— **Canal Corridor North project and the impact on reserves**

See further details on page 19.

Exercising of audit powers

We have a duty to consider whether to issue a report in the public interest about something we believe the Authority should consider, or if the public should know about.

We have not identified any matters that would require us to issue a public interest report.

In addition, we have not had to exercise any other audit powers under the Local Audit & Accountability Act 2014.

Acknowledgements

We would like to take this opportunity to thank officers and Members for their continuing help.

Section one

Control Environment

Organisational and IT control environment

We have identified no significant issues with the Authority's organisational and IT control environment and consider that the overall arrangements that have been put in place are reasonable.

Work completed

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would have implications for our audit. We obtain an understanding of the Authority's overall control environment and determine if appropriate controls have been implemented. We do not complete detailed testing of these controls.

[The Authority relies on information technology ("IT") to support both financial reporting and internal control processes. In order to satisfy ourselves that we can rely on the use of IT, we test controls over access to systems and data, system changes, system development and computer operations.

Key findings

We consider that your organisational and IT controls are effective overall. We have concluded that in respect of controls around property, plant and equipment – as outlined overleaf – there were deficiencies in previous years in the selection of appropriate valuation methodology. This has resulted in an adjustment to a prior-period adjustment to correct this error within the opening balances as at 1 April 2016. As the error was identified by the Authority and a full review of valuation methodologies has taken place, we have not raised any recommendations within this report in respect of this issue.

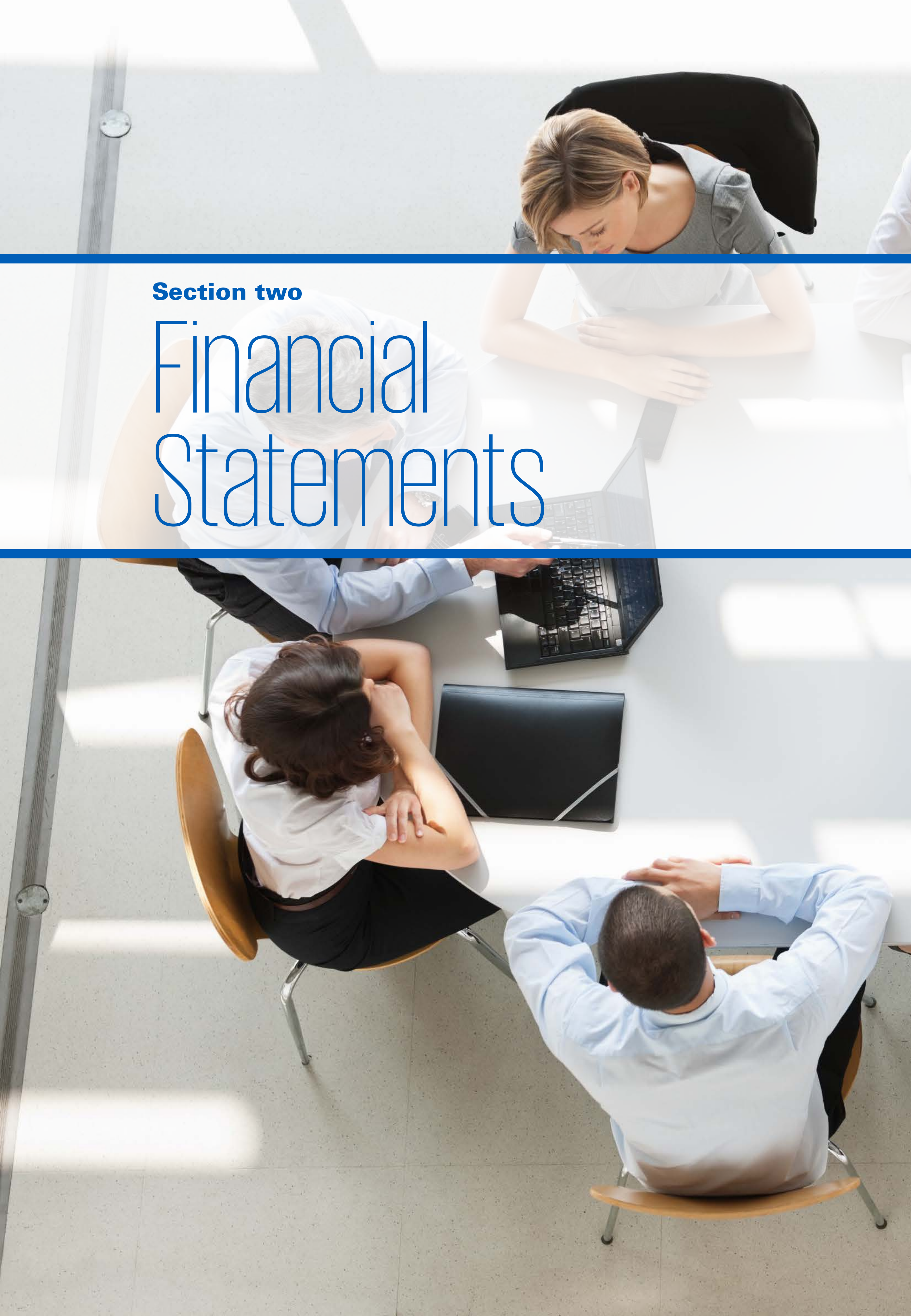
Aspect of controls	Assessment
Organisational controls:	
Management's philosophy and operating style	3
Culture of honesty and ethical behaviour	3
Oversight by those charged with governance	3
Risk assessment process	3
Communications	3
Monitoring of controls	3
IT controls:	
Access to systems and data	3
System changes and maintenance	3
Development of new systems and applications	3
Computer operations and end-user computing	3

Key	
1	Significant gaps in the control environment.
2	Deficiencies in respect of individual controls
3	Generally sound control environment.

Controls over key financial systems (cont.)

Aspect of controls	Assessment
Property, Plant and Equipment (including valuation controls)	2
Cash and Cash Equivalents	3
Pension Assets and Liabilities	3
Non pay expenditure	3
Payroll	3
Housing benefits expenditure	3
Business rates income	3
Council tax income	3
HRA rental income	3

Key	
1	Significant gaps in the control environment
2	Deficiencies in respect of individual controls
3	Generally sound control environment



Section two

Financial Statements

Accounts production and audit process

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

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

The Authority's overall process for the preparation of the financial statements is good.

The Authority has implemented all of the recommendations in our *ISA 260 Report 2016/17*.

Accounts practices and production process

The Authority incorporated a number of measures into its closedown plan to further improve the project management of this complex process. Specifically, the Authority recognised the additional pressures which the earlier closedown brought and we engaged with officers in the period leading up to the year end in order to proactively address issues as they emerge.

We also consider the Authority's accounting practices appropriate.

Going concern

The financial statements of the Authority have been prepared on a going concern basis. We confirm that we have identified no significant matters which would, in our view, affect the ability of the to continue as a going concern.

Implementation of recommendations

We raised a total of four recommendations in our ISA 260 Report 2016/17. The Authority has implemented all of the recommendations relating to the financial statements in line with the timescales of the action plan. Further details are included in Appendix 1.

Completeness of draft accounts

We received a complete set of draft accounts on 31st May 2018, which was the statutory deadline.

Quality of supporting working papers

We worked with management to ensure that working paper requirements are understood and aligned to our expectations. We are pleased to report that this has resulted in good-quality working papers with clear audit trails.

Response to audit queries

We are pleased to report that our agreed turnaround time for dealing with audit queries was achieved by Officers, including those who are not part of the finance team.

Specific audit areas

We anticipate issuing an unqualified audit opinion on the Authority's 2017-18 financial statements by 31 July 2018. We will also report that your Annual Governance Statement complies with the guidance issued by CIPFA/SOLACE ('Delivering Good Governance in Local Government') published in April 2016.

For the year ending 31 March 2018, the Authority has reported a deficit on provision of services of £1.9m. The impact on the General Fund has been an increase of £342k.

Auditing standards require us to consider two standard risks for all organisations. We consider these as a matter of course in our audit and will have set out the findings arising from our work in our ISA 260 Report below.

01

Management override of controls

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

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

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

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

02

Fraudulent revenue recognition

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

In our *External Audit Plan 2017-18* we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue.

This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.

Over the following pages we have set out our assessment of the specific significant risks and areas of audit focus we identified in relation to the audit of the Authority's financial statements.

Specific audit areas

Significant Audit Risks

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

Risk:

Valuation of PPE

The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Authority has adopted a rolling revaluation model which sees all land and buildings revalued over a three year cycle. As a result of this, however, individual assets may not be revalued for two years.

This creates a risk that the carrying value of those assets not revalued in year differs materially from the year end fair value. In addition, as the valuation is undertaken as at 1 April, there is a risk that the fair value is different at the year end.

Our assessment and work undertaken:

We reviewed the approach that the Authority adopted to assess the risk that assets not subject to valuation were materially misstated and considered the robustness of that approach. This is partly in response to the identification and correction by the Authority of a prior period error regarding the valuation methodology selected in respect of a specific asset.

In addition, we considered movements in market indices between revaluation dates and the year end in order to determine whether these indicate that fair values had moved materially over that time.

In relation to those assets which have been revalued during the year we reviewed the accounting entries made to record the results of the revaluation in order to ensure that they were appropriate.

We also assessed the valuer’s qualifications, objectivity and independence to carry out such valuations and reviewed the methodology used (including testing the underlying data and assumptions).

As a result of this work we have not identified any significant issues or material misstatements.

We have set out our view of the judgements and estimates used in relation to accounting for Property, Plant & Equipment at page 12.

Specific audit areas (cont.)

Significant Audit Risks (cont.)

Risk:

Pension Liabilities

The net pension liability represents a material element of the Authority's balance sheet. The Authority is an admitted body of Lancashire County Pension Fund, which had its last triennial valuation completed as at 31 March 2016. This forms an integral basis of the valuation as at 31 March 2018.

The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Authority's overall valuation.

There are financial assumptions and demographic assumptions used in the calculation of the Authority's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should also reflect the profile of the Authority's employees, and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes.

There is a risk that the assumptions and methodology used in the valuation of the Authority's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements.

Our assessment and work undertaken:

As part of our work we reviewed the controls that the Authority has in place over the information sent directly to the administering authority. Administering authority is responsible for submitting the information to the Scheme Actuary. We also liaised with the auditors of the Pension Fund in order to gain an understanding of the effectiveness of those controls operated by the Pension Fund. We also assessed the controls with respect to the management review of assumptions used in the valuation report and accounts. We also evaluated the competency, objectivity and independence of Mercers, the Scheme Actuary.

We reviewed the appropriateness of the key assumptions included within the valuation, compared them to expected ranges and involved a KPMG Actuary to provide a specialist assessment of those assumptions. We also reviewed the methodology applied in the valuation by Mercers.

In order to determine whether the net pension liability has been appropriately accounted for we also considered the valuation of pension assets. We obtained assurance from the Pension Fund auditors (Grant Thornton) over the overall value of fund assets. We then liaised with the actuary to understand how these assets are allocated across participating bodies and re-performed this allocation.

As a result of this work we have identified an adjustment relating to the treatment of the up-front payment of contributions at Appendix 2.

Further, we are awaiting confirmation from the scheme actuary of the procedures used to roll forward the valuation of pension fund assets, and any differences between the amounts estimated as at month 11 and the actual return on assets for the year to 31 March 2018. We are in the process of considering the information shared with the actuary around any special events or arrangements which may have impacted on this roll-forward process.

We have set out our view of the assumptions used in valuing pension assets and liabilities at page 12.

Specific audit areas (cont.)

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.

Issue:

Faster Close

In prior years, the Authority has been required to prepare draft financial statements by 30 June and then final signed accounts by 30 September. For years ending on and after 31 March 2018 however, revised deadlines apply which require draft accounts by 31 May and final signed accounts by 31 July.

In order to meet the revised deadlines, the Authority may need to make greater use of accounting estimates. In doing so, consideration will need to be given to ensuring that these estimates remain valid at the point of finalising the financial statements. In addition, there are a number of logistical challenges that will need to be managed. These include:

- Ensuring that any third parties involved in the production of the accounts (including valuers and actuaries) are aware of the revised deadlines and have made arrangements to provide the output of their work in accordance with this;
- Revising the closedown and accounts production timetable in order to ensure that all working papers and other supporting documentation are available at the start of the audit process;
- Ensuring that the Audit Committee meeting schedules have been updated to permit signing in July; and
- Applying a shorter paper deadline to the July meeting of the Audit Committee meeting in order to accommodate the production of the final version of the accounts and our ISA 260 report.

In the event that the above areas are not effectively managed there is the potential that the audit will not be completed by the 31 July deadline.

There is also an increased likelihood that the Audit Certificate (which confirms that all audit work for the year has been completed) may be issued separately at a later date if work is still ongoing in relation to the Authority's Whole of Government Accounts return. This is not a matter of concern and is not seen as a breach of deadlines.

Our assessment and work undertaken:

We liaised with officers in preparation for our audit in order to understand the steps that the Authority was taking in order to ensure it met the revised deadlines. We also advanced audit work into the interim visit in order to streamline the year end audit work.

The Authority incorporated a number of measures into its closedown plan to further improve the project management of this complex process. Specifically, the Authority recognised the additional pressures which the earlier closedown brought and we engaged with officers in the period leading up to the year end in order to proactively address issues as they emerge.

We received draft financial statements on the statutory deadline of 31 May 2018. The quality of this draft was consistent with that of prior years.

Judgements

We have considered the level of prudence within key judgements in your 2017-18 financial statements and accounting estimates. We have set out our view below across the following range of judgements.

Level of prudence

0	1	2	3	4	5	6
Audit Difference	Cautious		Balanced		Optimistic	**Audit Difference**

Acceptable Range

<table>
<tr><th>Subjective area</th><th>2017-18</th><th>2016-17</th><th>Commentary</th></tr>
<tr><td>Property Plant & Equipment: HRA Assets</td><td>3</td><td>0</td><td>The Authority continues its use of the beacon methodology in line with the DCLG’s *Stock Valuation for Resource Accounting* published in November 2016. We have reviewed the instructions provided and deem that the valuation exercise is in line with the instructions. In the prior year the incorrect Social Housing Local Adjustment Factor was used. We have confirmed that the correct factor was used in year and hence assessed the estimate as balanced.</td></tr>
<tr><td>Property Plant & Equipment: Non-HRA Assets</td><td>3</td><td>3</td><td>We have reviewed the assumptions by the Authority’s valuation specialist, who is a RICS-qualified surveyor. We consider that the assumptions adopted are reasonable and balanced, in line with our findings in 2016/17.</td></tr>
<tr><td>Valuation of pension assets and liabilities</td><td>3</td><td>4</td><td>The Authority continues to use Mercers to provide actuarial valuations in relation to the assets and liabilities recognised as a result of participation in the Local Government Pension Scheme. Due to the overall value of the pension assets and liabilities, small movements in the assumptions can have a significant impact on the overall valuation. The actual assumptions adopted by the actuary fell within our expected ranges as set our below:
<table>
<tr><th>Assumption</th><th>Actuary Value</th><th>KPMG Central</th><th>Assessment</th></tr>
<tr><td>Discount rate</td><td>2.60%</td><td>2.50%</td><td>4</td></tr>
<tr><td>Pension increase rate</td><td>2.20%</td><td>2.16%</td><td>3</td></tr>
<tr><td>Salary increase</td><td>CPI plus 1.5%</td><td>CPI plus 0% to 2%</td><td>3</td></tr>
<tr><td>Life expectancy
Males currently aged 45 / 65
Females currently aged 45/65</td><td>25.0/ 22.7
28.0/ 25.4</td><td>23.5/22.1
25.4/23.9</td><td>1</td></tr>
</table>
As outlined on Page 11, we are awaiting confirmation from the scheme actuary of the procedures used to roll forward the valuation of pension fund assets, and any differences between the amounts estimated as at month 11 and the actual return on assets for the year to 31 March 2018. We are in the process of considering the information shared with the actuary around any special events or arrangements which may have impacted on this roll-forward process.</td></tr>
</table>

Proposed opinion and audit differences

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's 2017-18 financial statements following approval of the Statement of Accounts by the Audit Committee on 24th July 2018.

Audit differences

In accordance with ISA 260 we are required to report uncorrected audit differences to you. We also report any material misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities.

The final materiality (see Appendix 3) for this year's audit was set at £2.9 million. Audit differences below £145 thousand are not considered significant.

Our audit identified a total of one significant audit difference, which we set out in Appendix 2. It is our understanding that these will be adjusted in the final version of the financial statements.

The tables below illustrate the total impact of audit differences on the Authority's movements on the General Fund for the year and balance sheet as at 31 March 2018. There is no net impact on the General Fund as a result of audit adjustments. This is the result of the following amendments:

— The Authority took the option of making an up-front payment of pension contributions (both deficit reduction payments and ongoing service contributions) at the start of 2017/18. The effect of two-thirds of this up-front contribution was excluded from the actuarial valuation of the defined benefit pension liability, and instead a prepayment was recognised on the Balance Sheet. The appropriate treatment is to recognise in full the contributions in both the CIES and through the reduction to the defined benefit pension liability. Costs in the CIES are then reversed out and replaced by the current service cost calculated by the actuary. The effect of the change on the General Fund is nil, as the impact of the up-front contributions on the General Fund is under the revised accounting treatment is still able to be spread across the three years to which the up-front payment relates.

In addition, we identified a small number of presentational adjustments required to ensure that the accounts are compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2017-18 ('the Code').

Movement on the General Fund 2017-18

£m	Pre-Audit	Post-Audit	Ref[1]
Deficit on the provision of services	1,969	96	1
Adjustments between accounting basis and funding basis under regulations	7,602	5,729	1
Increase in General Fund and Housing Revenue Account (before transfers to earmarked reserves)	**5,633**	**5,633**	

Balance Sheet as at 31 March 2018

£m	Pre-Audit	Post-Audit	Ref[1]
Current assets	19,192	13,193	1
Long term liabilities	59,197	51,324	1
Unusable reserves	143,424	145,297	1
Total Reserves	**173,041**	**174,914**	**1**

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[1] See referenced adjustments in Appendix 3.

Proposed opinion and audit differences (cont.)

Annual governance statement

We have reviewed the Authority's 2017-18 Annual Governance Statement and confirmed that it is not misleading and is consistent with other information we are aware of from our audit of the financial statements.

Narrative report

We have reviewed the Authority's 2017-18 narrative report and have confirmed that it is consistent with the financial statements and our understanding of the Authority.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's 2017/18 financial statements.

Before we can issue our opinion we require a signed management representation letter.

Once we have finalised our opinions and conclusions we will prepare our Annual Audit Letter and close our audit.

Declaration of independence and objectivity

As part of the finalisation process we are required to provide you with representations concerning our independence.

In relation to the audit of the financial statements of Lancaster City Council for the year ending 31 March 2018, we confirm that there were no relationships between KPMG LLP and Lancaster City Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 5 in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Responsible Finance Officer for presentation to the Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

ISA 260 requires us to communicate to you by exception 'audit matters of governance interest that arise from the audit of the financial statements' which include:

- Significant difficulties encountered during the audit;
- Significant matters arising from the audit that were discussed, or subject to correspondence with management;
- Other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process; and
- Matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. significant deficiencies in internal control; issues relating to fraud, compliance with laws and regulations, subsequent events, non disclosure, related party, public interest reporting, questions/objections, opening balances etc.).

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority's 2017-18 financial statements.

Section three

Value for Money Arrangements

Specific value for money risk areas

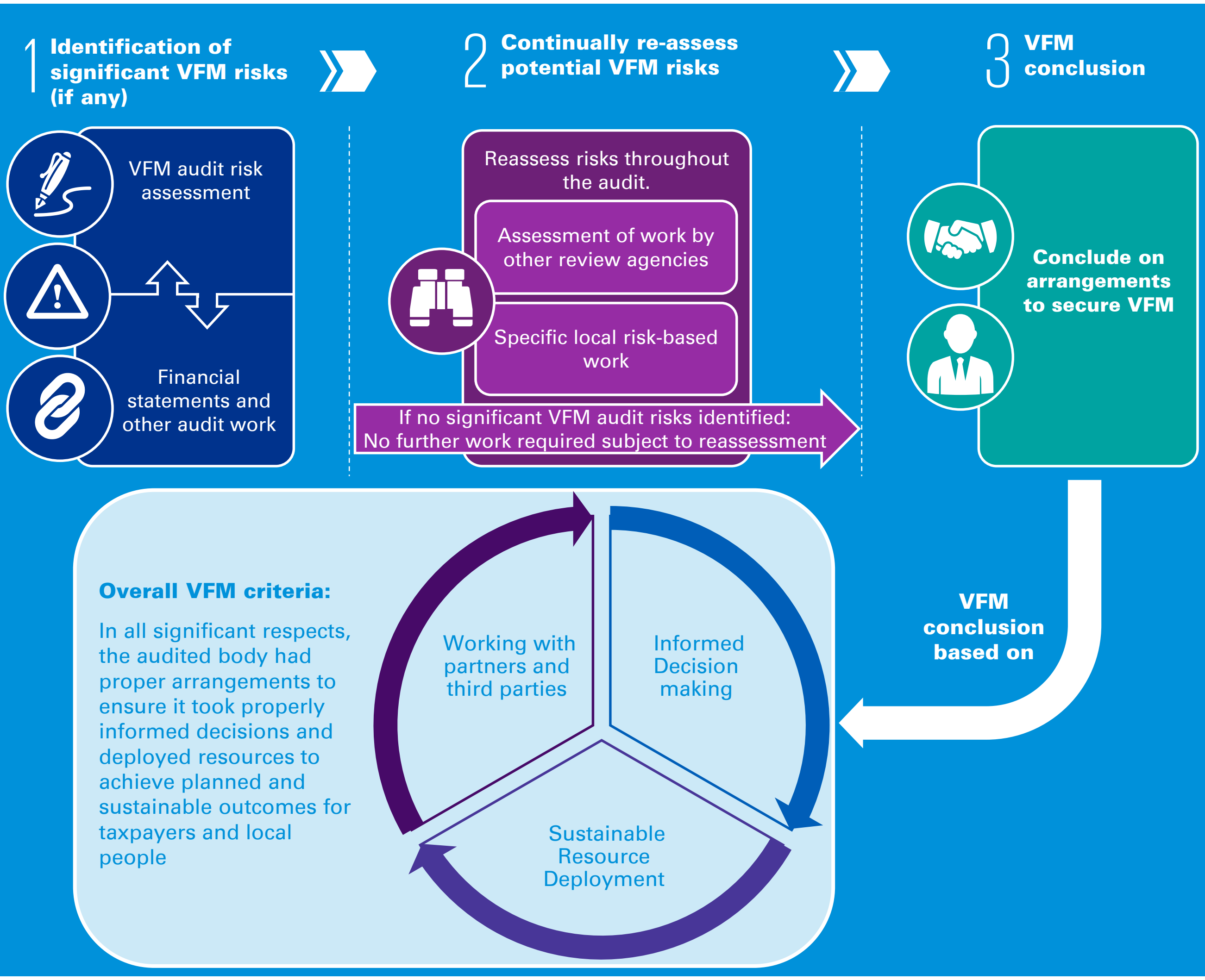
Our 2017-18 VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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

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.'

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



1 **Identification of significant VFM risks (if any)**

VFM audit risk assessment

Financial statements and other audit work

2 **Continually re-assess potential VFM risks**

Reassess risks throughout the audit.

Assessment of work by other review agencies

Specific local risk-based work

If no significant VFM audit risks identified:
No further work required subject to reassessment

3 **VFM conclusion**

Conclude on arrangements to secure VFM

VFM conclusion based on

Overall VFM criteria:

In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people

Working with partners and third parties

Informed Decision making

Sustainable Resource Deployment

Specific value for money risk areas (cont.)

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

Applicability of VFM Risks to VFM sub-criteria

VFM Risk	Informed decision making	Sustainable resource deployment	Working with partner and third parties
Canal Corridor North project and impact on reserves	■	■	■

In consideration of the above, we have concluded that in 2017-18, the Authority has made proper arrangements to ensure it took properly-informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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

Specific value for money risk areas (cont.)

As communicated to you in our *External Audit Plan 2017-18,* we have identified one risk requiring specific audit attention and procedures to address the likelihood that proper arrangements are not in place to deliver value for money.

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 have provided below a summary of the risk area identified, our work undertaken and the conclusions reached.

Risk:

Canal Corridor North and impact on reserves

Lancaster City Council were working with developer British Land to bring forward options to deliver a new retail and leisure quarter for the city of regional importance. Lancaster University is also a key partner in this project, as part of the development is likely to centre on an innovative offer to prospective students.

The City Council were working with British Land, Lancaster University and other key partners to agree final proposals which achieve the best for the city and the wider district.

The original timetable for the project included agreement on heads of terms in early 2018 with a planning application by the end of the year. This project, if it goes ahead, will require a significant investment from all parties, and thus impact the reserves of the Council. Therefore appropriate risk analysis and scrutiny of the financial implications of the project are crucial to the decision making process of the Council.

Our assessment and work undertaken:

The Canal Corridor North project has not progressed in line with the timescales indicated during our planning. No formal agreements have been made and therefore there has been no formal sign off or agreement of heads of terms.

We are aware that British Land are no longer involved in the project and the development agreement has been terminated. There were no outstanding liabilities associated with this termination of contract.

The Council will now continue to work to establish a master plan for the area of land later this year.

As a result of our work we have not identified any issues that would impact on our VFM conclusion.

Appendices

Follow-up of prior year recommendations

The Authority has implemented all of the recommendations raised through our previous audit work.

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2016/17* and re-iterates any recommendations still outstanding.

Number of recommendations that were	
Included in the original report	4
Implemented in year or superseded	4

No.	Risk	Issue & Recommendation	Status as at July 2018
1	2	Our testing of controls over non-pay expenditure identified two instances where purchase orders were not matched to a purchase order, despite an approved purchase order existing within the system. Purchase orders should be matched to an approved purchase order, as this represents the strongest possible control of non-pay expenditure. While the invoices in question were approved by the appropriate member of staff, controls are strengthened when a full three-way match process is followed, whereby: a purchase requisition is approved and a purchase order created; the goods or services are receipted on the purchasing system; and purchase invoices are matched to the approved purchase order. ***Recommendation*** We recommend that: — Wherever possible, an approved purchase order is in place for all non-pay expenditure; and — Purchase invoices are matched to the associated purchase order within the system prior to payment.	Our testing of controls over non-pay expenditure for the 17/18 year has not identified any instances of this happening. **Implemented**

Appendix 1:

Follow-up of prior year recommendations

No.	Risk	Issue & Recommendation	Status as at July 2018
2	3	Our controls audit identified that monthly reconciliations between the Academy system and VOA property schedules were signed as reviewed but not by the individual preparing the reconciliation. Therefore, while we had evidence that the control had been conducted appropriately, we did not have adequate evidence that segregation of duties between the preparation and review of the reconciliation was in place during the year. While the risk around control failure is, in this instance, limited, a valid audit trail for the separate preparation and review of reconciliations should be maintained. ***Recommendation*** We recommend that all reconciliations are signed by both the individual preparing and reviewing the reconciliations, in order to maintain an effective audit trail of segregation of duties in the operation of reconciliation controls.	Our testing of monthly reconciliations for 17/18 year has not identified any instances of this happening. **Implemented**
3	2	Our related parties testing identified seven current members who did not have an updated Declaration of Interests form for 2016/17. In all cases, the most recent signed declaration was completed during the 2015/16 financial year. There is a risk that if the Council does not maintain an adequate and timely record of member interests, that material related party transactions are not identified and reported in the Council's Statement of Accounts. ***Recommendation*** We recommend that all members complete an updated Declaration of Interest at least annually.	Our testing of related party declarations for the 17/18 year has not identified any instances of this happening. **Implemented**
4	2	Our year-end financial statements audit identified that the Social Housing Local Adjustment Factor adopted in establishing the valuation of HRA properties at the year-end was not updated for the latest guidance issued by DLCG in November 2016. Consequently, an adjustment factor of 35% was used, rather than the 40% as per the updated guidance for 2016/17. This has resulted in an adjusted audit difference in the Statement of Accounts for 2016/17. This indicates that there is a risk around updates to valuation methodologies in accordance with latest national guidance. ***Recommendation*** We recommend that all revaluation work undertaken by the Council's expert valuation specialist is conducted after thorough review of available national and local guidance. The outcome of the revaluation exercise should be reviewed closely by senior Finance officers with reference to the extant guidance, to ensure that further misstatements of this nature do not occur.	Our testing identified that the Authority used an appropriate Social Housing Local Adjustment Factor for the 17/18 year. **Implemented**

Appendix 2:

Audit differences

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

We are also required to report all material misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities.

A number of minor amendments focused on presentational improvements have also been made to the 2017-18 draft financial statements. The Finance team is committed to continuous improvement in the quality of the financial statements submitted for audit in future years.

Adjusted audit differences

The following table sets out the significant audit differences identified by our audit of Lancaster City Council's financial statements for the year ended 31 March 2018.

Table 1: Adjusted audit differences (£'000)

No.	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Basis of audit difference
1	Dr Cost of Services Expenditure £1,642 Cr Cost of Services Income £3,515	Cr Comprehensive income and expenditure £1,873 Dr Adjustments between accounting basis and funding basis £1,873	Cr Short Term Debtors 5,999	Dr Other Long Term Liabilities £7,872	Cr Unusable Reserves £1,873	Relates to the recording of up-front pension contributions. See commentary on Page 13.
	Cr 1,873	**Dr/Cr Nil**	**Cr 5,999**	**Dr 7,872**	**Cr 1,873**	**Total impact of adjustments**

Unadjusted audit differences

We are pleased to report that there are no unadjusted audit differences.

Presentational adjustments

We identified a number of presentational adjustments required to ensure that the Authority's financial statements for the year ending 31 March 2018 are fully compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2017-18 ('the Code').

Appendix 3:

Materiality and reporting of audit differences

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

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

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

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

We used the same planning materiality reported in our *External Audit Plan 2017-18*, presented to you in February 2018.

Materiality for the Authority's accounts was set at £2.9 million which equates to around 2.0% of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit Committee

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

Under ISA 260, we are obliged to report omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

ISA 450 requires us to request that uncorrected misstatements are corrected.

In the context of the Authority, an individual difference is considered to be clearly trivial if it is less than £145 thousand for the Authority.

Where management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit Committee to assist it in fulfilling its governance responsibilities.

Appendix 4:

Required communications with the Audit Committee

We have provided below at-a-glance summary of the information we are required to report to you in writing by International Accounting Standards.

Required Communication	Commentary
Our draft management representation letter	We have not requested any specific representations in addition to those areas normally covered by our standard representation letter for the year ended 31 March 2018.
Adjusted audit differences	We have identified one adjusted audit differences with a total value of £6.2 million. See page 23 for details. These adjustments result in a net decrease of £1.9 million in the reported deficit provision of services. See page 23 for further details.
Unadjusted audit differences	We are pleased to report that there are no unadjusted audit differences..
Related parties	There were no significant matters that arose during the audit in connection with the entity's related parties.
Other matters warranting attention by the Audit Committee	There were no matters to report arising from the audit that, in our professional judgment, are significant to the oversight of the financial reporting process.
Control deficiencies	We have set out our assessment of the Authority's internal control environment, including confirmation that there were no significant deficiencies identified, in Section one of this report (see pages 3 to 5). We have identified no any deficiencies in internal control of a lesser magnitude than significant deficiencies.
Actual or suspected fraud, noncompliance with laws or regulations or illegal acts	We identified no actual or suspected fraud involving the Authority's Member or officers with significant roles in internal control, or where the fraud resulted in a material misstatement in the financial statements.
Significant difficulties	No significant difficulties were encountered during the audit.
Modifications to auditor's report	There are no modifications to our audit report.
Disagreements with management or scope limitations	The engagement team had no disagreements with management and no scope limitations were imposed by management during the audit.

Appendix 4:

Required communications with the Audit Committee (cont.)

Required Communication	Commentary
Other information	No material inconsistencies were identified related to other information in the Narrative Report or Annual Governance Statement. These reports were found to be fair, balanced and comprehensive, and compliant with applicable requirements.
Our declaration of independence and any breaches of independence	No matters to report. The engagement team have complied with relevant ethical requirements regarding independence. See Appendix 5 for further details.
Accounting practices	Over the course of our audit, we have evaluated the appropriateness of the Authority's accounting policies, accounting estimates and financial statement disclosures. In general, we believe these are appropriate. We have set out our view of the assumptions used in valuing pension assets and liabilities at page 12.
Significant matters discussed or subject to correspondence with management	There were no significant matters arising from the audit which were discussed, or subject to correspondence, with management.

Appendix 5:

Declaration of independence

ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF LANCASTER CITY COUNCIL

Professional ethical standards require us to provide to you at the conclusion of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed.

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code of Audit Practice, the provisions of Public Sector Audit Appointments Limited's ('PSAA's') Terms of Appointment relating to independence, the requirements of the FRC Ethical Standard and the requirements of Auditor Guidance Note 1 - General Guidance Supporting Local Audit (AGN01) issued by the National Audit Office ('NAO') on behalf of the Comptroller and Auditor General.

This Statement is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP partners, Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Communications
- Internal accountability
- Risk management
- Independent reviews.

We are satisfied that our general procedures support our independence and objectivity.

Independence and objectivity considerations relating to the provision of non-audit services

Summary of fees

We have considered the fees charged by us to the authority and its controlled entities for professional services provided by us during the reporting period.

We have detailed the fees charged by us to the authority and its controlled entities for significant professional services provided by us during the reporting period in Appendix 7, as well as the amounts of any future services which have been contracted or where a written proposal has been submitted. Total fees charged by us for the period ended 31 March 2018 can be analysed overleaf.

Appendix 5:

Declaration of independence (cont.)

	2017-18 £	2016-17 £
Audit of the Authority	58,388	58,388
Total audit services	**58,388**	**58,388**
Audit related assurance services	3,000	3,000
Mandatory assurance services	9,573	7,740
Total Non Audit Services	**12,573**	**10,740**

We are required by AGN 01 to limit the proportion of fees charged for non-audit services (excluding mandatory assurance services) to 70% of the total fee for all audit work carried out in respect of the Authority under the Code of Audit Practice for the year. The ratio of non-audit fees to audit fees for the year was 0.22:1. We do not consider that the total of non-audit fees creates a self-interest threat since the absolute level of fees is not significant to our firm as a whole.

Facts and matters related to the provision of non-audit services and the safeguards put in place that bear upon our independence and objectivity, are set out table on the following page.

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the Audit Committee.

Confirmation of audit independence

We confirm that as of the date of this report, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the partner and audit staff is not impaired.

This report is intended solely for the information of the Audit Committee of the authority and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

KPMG LLP

KPMG LLP

Appendix 5:

Declaration of independence (cont.)

Analysis of Non-audit services for the year ended 31 March 2018

Description of scope of services	Principal threats to independence and Safeguards applied	Basis of fee	Value of services delivered in the year ended 31 March 2018 £	Value of services committed but not yet delivered £
Audit-related assurance services				
Assurance report for grant claim no longer within the PSAA regime – Pooling of Housing Capital Receipts	**Self-interest**: This engagements is entirely separate from the audit through separate contracts. The fee rate is low in comparison to the audit fees and is not contingent on any outcomes from the assurance work. **Self-review:** The nature of this work is to provide an independent assurance report to the relevant external body. This does not impact on our other audit responsibilities and there is no threat of our work under this engagement being reviewed through our audit. **Management threat:** This work provides a separate assurance report and does not impact on any management decisions. **Familiarity:** This threat is limited given the scale, nature and timing of the work. **Advocacy:** We will not act as advocates for the Council in any aspect of this work. The output is an independent assurance report to the relevant external body applying an approach issued by that body. **Intimidation:** not applicable to these areas of work.	Fixed daily rate	0	3,000
Mandatory assurance services				
Grant Certification – Housing Benefit Subsidy Return	The nature of this mandatory assurance service is to provide independent assurance on each of the returns. As such we do not consider it to create any independence threats.	Fixed Fee	0	9,573

Appendix 6:

Audit fees

As communicated to you in our *External Audit Plan 2017-18*, our scale fee for the audit is £58,388 plus VAT (£58,388 in 2016/17), which is consistent with the prior year.

Our work on the certification of the Authority's Housing Benefit Subsidy return is planned for August 2018. The planned scale fee for this is £9,573 plus VAT (£7,740 in 2016/17). Planned fees for other grants and claims which do not fall under the PSAA arrangements amount to £3,000 plus VAT (£3,000 in 2016/17), see further details below.

Component of the audit	2017-18 Planned Fee £	2016-17 Actual Fee £
Accounts opinion and value for money work		
PSAA Scale fee (Lancaster City Council)	58,388	58,388
Additional fee for work in response to elector challenge (relating to 2015/16 financial statements)	-	5,000
Total audit services	**58,388**	**63,388**
Mandatory assurance services		
Housing Benefits Certification (work planned for August)	9,573	7,740
Total mandatory assurance services	**9,573**	**7,740**
Audit-related assurance services		
Pooling of Housing Capital Receipts (work planned for September)	3,000	3,000
Total audit-related assurance services	**3,000**	**3,000**
Total non-audit services	**12,573**	**10,740**
Grand total fees for the Authority	**70,961**	**74,128**

All fees quoted are exclusive of VAT.

The key contacts in relation to our audit are:

Tim Cutler
Partner

T: +44 (0) 161 246 4774

E: tim.cutler@kpmg.co.uk

Chris Paisley
Senior Manager

T: +44 (0) 161 246 4934
E: christopher.paisley@kpmg.co.uk

Sophie Watson
Manager

T: +44 (0) 161 246 4378
E: sophie.watson@kpmg.co.uk

kpmg.com/uk

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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