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

Lancaster City Council

September 2014



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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled *Statement of Responsibilities of Auditors and Audited Bodies*. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document which is available on the Audit Commission's website at [www.auditcommission.gov.uk](http://www.auditcommission.gov.uk).

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

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Timothy Cutler, the appointed engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, or by email to [trevor.rees@kpmg.co.uk](mailto:trevor.rees@kpmg.co.uk), who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, 3<sup>rd</sup> Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to [complaints@audit-commission.gsi.gov.uk](mailto:complaints@audit-commission.gsi.gov.uk). Their telephone number is 0303 4448 330.

## This document summarises:

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

## Scope of this report

This report summarises the key findings arising from:

- our audit work at Lancaster City Council ('the Authority') in relation to the Authority's 2013/14 financial statements; and
- the work to support our 2013/14 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

## Financial statements

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



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

We are now in the final phase of the audit, the completion stage. Some aspects of this stage are also discharged through this report.

## VFM conclusion

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

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

## Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our audit work in relation to the 2013/14 financial statements.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1. We have also reviewed your progress in implementing prior recommendations and this is detailed in Appendices 2 and 3.

## Acknowledgements

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

This table summarises the headline messages. Sections three and four of this report provide further details on each area.

<b>Proposed audit opinion</b>	We anticipate issuing an unqualified audit opinion by 30 September 2014. We will also report that the wording of your Annual Governance Statement accords with our understanding.
<b>Audit adjustments</b>	Our audit has not identified any significant audit adjustments; however a number of presentational changes have been made to the notes to the Financial Statements which have been agreed with management and changed in the final version of the Financial Statements.
<b>Key financial statements audit risks</b>	<p>We have worked with Officers and performed work in relation to the key areas of audit focus identified during the planning phase of our audit.</p> <p>We have revisited our assessment of risk throughout the year and identified one new significant risk area relating to national non-domestic rates provisions within the Authority's 2013/14 financial statements.</p> <p>We are satisfied that the Authority has appropriate arrangements in place to address the risks and issues that we have identified.</p>
<b>Accounts production and audit process</b>	<p>The quality of the accounts and the supporting working papers has been maintained at a high standard in 2013/14, which assists with the delivery of an effective and efficient audit. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales.</p> <p>The Authority has implemented all of the recommendations in our <i>ISA 260 Report 2012/13</i> relating to the Financial Statements.</p>
<b>Control environment</b>	<p>The Authority's organisation and control environment is effective and controls over the key financial systems are sound.</p> <p>We are satisfied that internal audit are compliant with the Code of Practice for Internal Audit in Local Government and have again been able to place reliance on their work where this was relevant to our work.</p> <p>We have raised two recommendations that will strengthen the Authority's control environment. These are detailed in Appendix 1.</p>

This table summarises the headline messages. The remainder of this report provides further details on each area.

<b>Completion</b>	<p>At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas:</p> <ul style="list-style-type: none"> <li>■ Review of the Annual Governance statement</li> <li>■ Whole of Government Accounts review</li> <li>■ A review of any post balance sheet events up to the date of signing our audit report.</li> </ul> <p>Before we can issue our opinion we require a signed management representation letter.</p> <p>We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.</p>
<b>VFM conclusion and risk areas</b>	<p>We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.</p> <p>We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2014.</p>

**We have not identified any material misstatements during the course of our audit.**

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

### **Proposed audit opinion**

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion by 30 September 2014.

### **Audit differences**

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

We did not identify any material misstatements as a result of our audit work. There are no adjusted or unadjusted audit differences to report in 2013/14.

We identified a number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting the United Kingdom 2013/14 ('the Code')*. These have been agreed with management and changed in the final version of the Financial Statements.

### **Annual Governance Statement**

We have reviewed the Annual Governance Statement and confirmed that:

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

### **Explanatory Foreword**

We have reviewed the Authority's explanatory foreword and can confirm it is not inconsistent with the financial information contained in the audited financial statements.

We have worked with Officers throughout the year to discuss specific areas of audit focus. The Authority addressed the issues appropriately.


In our External Audit Plan 2013/14, we identified three areas of audit focus. We have now completed our testing of these areas and set out our evaluation following our substantive work.

We have revisited our assessment of risk throughout the year and identified one new significant risk area relating to national non-domestic rates provisions within the Authority's 2013/14 financial statements.


The table below sets out our detailed findings for each of the areas identified.

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

Our controls testing and substantive procedures, covering journal entries, accounting estimates and significant transactions that are outside the normal course of business, did not identify any issues.


Significant risk	Issue identified during our audit	Findings
	<p>The introduction of the Business Rates Retention Scheme in April 2013 means local authorities are liable for the cost of successful business rates appeals, up to the level of the annual safety net. For Lancaster this was £376,000 in 2013/14.</p> <p>The Authority is therefore required to recognise a provision within the financial statements which estimates the potential cost of outstanding appeals up until 31 March 2014.</p> <p>Within Lancaster, two of the hereditaments under appeal relate to power stations for which there is little comparable data available.</p> <p>As the calculation of the provision requires management to make significant assumptions and judgements, there is a high level of estimation uncertainty in relation to this balance within the financial statements.</p>	<p>In line with the new arrangements, the Authority has included a provision of £9.042M for appeals against NNDR valuations in the collection fund, with the Authority's share of this in the balance sheet being £3.617M (40%).</p> <p>The Authority has chosen to use an expert, Inform-CPI, to assist them in calculating this estimate.</p> <p>Our initial review highlighted that the vast majority of the provision balance (£7.228M) relates to the Heysham power station sites. However we were unable to establish how Inform-CPI's estimate had been calculated and the assumptions that had been used.</p> <p>Due to the unique nature of the power station, the lack of appeals data for similar properties and the significant impact this balance has on the financial statements, we requested that the Authority contact Inform-CPI to obtain the detailed calculations and a method statement.</p> <p>Following receipt of this additional information and discussions between KPMG and Inform-CPI, we are satisfied with the basis of estimate for the NNDR provision included within the financial statements.</p> <p>In future, it is important that management are able to assure themselves that all key assumptions and balances within the financial statements, including those made by third parties, are materially accurate, and can be supported by a clear audit trail. We have included a recommendation in Appendix 1 to reflect this.</p>

We have worked with Officers throughout the year to discuss specific areas of audit focus. The Authority addressed the issues appropriately.


Area of Audit Focus	Issue as reported in our plan	Update and findings
	<p>As at February 2014, the Authority has achieved £243,000 (80%) of the £303,000 savings required to meet its 2013/14 budget and is projecting an under spend of £13,000 which will be transferred into balances. This is after identifying growth opportunities worth £213,000 and after allowing for planned contributions to reserves of £367,000.</p> <p>The Authority estimates it will need to make savings of £260,000 in 2014/15 and will need to find savings of £1.0m in 2015/16 and £2.5m in 2016/17. Against a backdrop of continued demand pressures, it will become more and more difficult to deliver these savings in a way that secures longer term financial and operational sustainability.</p>	<p>The final outturn for 2013/14 represented an under-spend of £277,000 against the budget, which was updated and revised in January 2014.</p> <p>During the year, the Authority has achieved its savings targets in order to manage the reductions in Local Government funding. In total, efficiencies and savings of approximately £513,000 have been achieved mainly from service restructures (£197k), vehicle procurement savings (£60k) and the surrender of the Lancaster Market headlease (£167k).</p> <p>The Council has established and implemented a savings plan to achieve the required savings over the next 3 years.</p> <p>For 2014/15, savings of £1,053,000 have already been identified which will bridge the Authority's budget gap. These have been achieved again mainly through service restructures (£658k), vehicle procurement savings (£167k) and the surrender of the Lancaster Market head lease (£145k).</p> <p>Our detailed budgetary control testing found the Authority has robust procedures in place to monitor budget variances and implement remedial action as necessary.</p> <p>We will continue to monitor the Authority's financial position going forward to ensure that savings targets are being achieved and performance with expectations and budget.</p>



We have worked with Officers throughout the year to discuss specific areas of audit focus. The Authority addressed the issues appropriately.

Area of Audit Focus	Issue as reported in our plan	Update and findings
	<p><u>Lancaster Market</u></p> <p>The Lancaster Market Lease was surrendered in May 2013. The surrender resulted in a significant payment of £11.7m to break the lease and this transaction will be accounted for in full in the 2013/14 financial statements.</p> <p>This will involve the de-recognition of the market hall asset and related lease liability but there will be a requirement to recognise the surrender payment.</p> <p><u>Luneside East</u></p> <p>During our 2012/13 audit, the Authority appealed against the Land Tribunal's compensation award in respect of the Luneside East project, where the Authority exercised compulsory purchase order powers to purchase land. The Authority was successful in its appeal to the Court of Appeal on three of the four heads of the compensation claim. As such, the Lands Tribunal are required to re-determine the associated compensation award and the liability for costs.</p> <p>Officers believe that the revised costs award should be known before the end of the financial year and therefore they will be required to reflect this updated position within the 2013/14 financial statements.</p>	<p><u>Lancaster Market</u></p> <p>As part of our year-end substantive testing, we have reviewed the accounting entries relating to the Lancaster Market Lease surrender and we are satisfied that this transaction has been accounted for in accordance with the <i>Code of Practice on Local Authority Accounting in the UK</i>.</p> <p>As a result of the lease surrender, the Council no longer has any financial liability in respect of the market and all corresponding assets have also been removed from the accounts.</p> <p><u>Luneside East</u></p> <p>Since the conclusion of the Upper Tribunal (Lands Chamber) case in 2012/13, the land owner has made an application to the Court of Appeal to seek permission to appeal the Upper Tribunals decision relating to compensation on the grounds that new information has come to light.</p> <p>The Authority's legal counsel considers that there is no merit to the appeal in this application, however the Authority will be required to defend their position before the case is concluded.</p> <p>As such, the Authority is unable to determine the cost award at this stage and continues to include a related contingent asset and liability within the Financial Statements.</p>

We have worked with Officers throughout the year to discuss specific areas of audit focus. The Authority addressed the issues appropriately.

Area of Audit Focus	Issue	Findings
	<p>During the year, the Local Government Pension Scheme for Lancashire (the Pension Fund) has undergone a triennial valuation with an effective date of 31 March 2013 in line with the Local Government Pension Scheme (Administration) Regulations 2008. The Authority's share of pensions assets and liabilities is determined in detail, and a large volume of data is provided to the actuary in order to carry out this triennial valuation.</p> <p>The IAS 19 numbers to be included in the financial statements for 2013/14 will be based on the output of the triennial valuation rolled forward to 31 March 2014. For 2014/15 and 2015/16 the actuary will then roll forward the IAS 19 position based on more limited data.</p> <p>There is a risk that the data provided to the actuary for the valuation exercise is inaccurate and that these inaccuracies affect the actuarial figures in the accounts. Most of the data is provided to the actuary by Lancashire County Council who administer the Pension Fund.</p>	<p>During 2013/14, the Authority's pension deficit has decreased by £11.5m as a result of the following movements in pension assets and liabilities:</p> <ul style="list-style-type: none"> <li>■ The current valuation of pension liabilities has decreased from £178.8million at 31 March 2013 to £162.6million at 31 March 2014.</li> <li>■ This has been offset by an decrease in the asset value of £4.7million.</li> <li>■ There has been an actuarial gain of £14.1m in relation to the changes in actuarial assumptions used to value the Scheme's liabilities.</li> </ul> <p>As part of our audit, we have reviewed the Authority's IAS 19 assumptions as at 31 March 2014 against KPMG's acceptable range and consider these to fall within our acceptable range.</p> <p>In addition, we have agreed the data provided by the Authority to the actuary back to the systems and reports from which it was derived, to ensure the accuracy of this data.</p> <p>Throughout the audit process, we have liaised with Grant Thornton, who are the auditors of the Pension Fund, to gain assurance over accuracy and completeness of source data provided by the Pension Fund to the scheme actuary.</p> <p>We have also reviewed the accounts to ensure they include appropriate disclosures and have reviewed the accounting treatment for annual pension charges included in the Income and Expenditure account.</p>

The Authority has prepared high quality accounts and supporting working papers.

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

The Authority has implemented all of the recommendations in our *ISA 260 Report 2012/13* relating to the financial statements.

### Accounts production and audit process

ISA 260 requires us to communicate to you our views about the significant qualitative aspects of the Authority's accounting practices and financial reporting. We also assessed the Authority's process for preparing the accounts and its support for an efficient audit. We considered the following criteria:

Element	Commentary
<b>Accounting practices and financial reporting</b>	<p>The Authority has maintained the good quality of its financial reporting process.</p> <p>We consider that accounting practices are appropriate.</p> <p>We have also reviewed key areas of judgement applied by management in preparing the financial statements and are satisfied that these are appropriately supported. We have made a recommendation in relation to verification of information provided by third parties, details of which are included in Appendix 1.</p>
<b>Completeness of draft accounts</b>	<p>We received a complete set of draft accounts on 7 July 2014. The accounts were signed by the Chief Officer (Resources) before the 30 June deadline.</p>
<b>Quality of supporting working papers</b>	<p>Our <i>Prepared by Client List</i> set out our working paper requirements for the audit. The quality of working papers provided was high and met our requirements.</p>
<b>Response to audit queries</b>	<p>Officers resolved the majority of audit queries in a reasonable time.</p>

### Prior year recommendations

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

The Authority has implemented all of the recommendations in our *ISA 260 Report 2012/13*. Appendix 2 provides further details.

The Authority has implemented all of the recommendations outstanding from our *ISA 260 Report 2010/11*. Appendix 3 provides further details.

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

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

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

### Declaration of independence and objectivity

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

In relation to the audit of the financial statements of Lancaster City Council for the year ending 31 March 2014, 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 Audit Commission's 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 Financial Services Manager for presentation to the Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

### Other matters

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

- significant difficulties encountered during the audit;
- significant matters arising from the audit that were discussed, or subject to correspondence with management;
- other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process; and

- matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. significant deficiencies in internal control; issues relating to fraud, compliance with laws and regulations, subsequent events, non disclosure, related party, public interest reporting, questions/objections, opening balances etc).

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority's 2013/14 financial statements.

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

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

### Background

Auditors are required to give their statutory VFM conclusion based on two criteria specified by the Audit Commission. These consider whether the Authority has proper arrangements in place for:

- securing financial resilience: looking at the Authority's financial governance, financial planning and financial control processes; and
- challenging how it secures economy, efficiency and effectiveness: looking at how the Authority is prioritising resources and improving efficiency and productivity.

We follow a risk based approach to target audit effort on the areas of greatest audit risk. We consider the arrangements put in place by the Authority to mitigate these risks and plan our work accordingly.

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

### Work completed

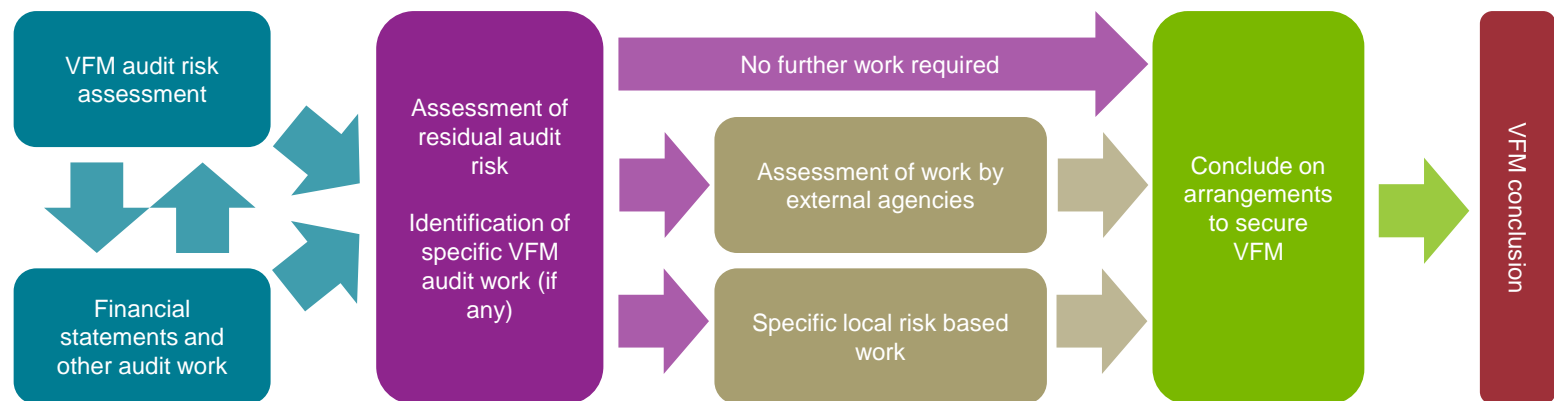
We performed a risk assessment earlier in the year and have reviewed this throughout the year.

We have not identified any significant risks to our VFM conclusion and therefore have not completed any additional work.

### Conclusion

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

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



We identified two VFM risks within our audit plan.

In both cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

#### Work completed


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

- assessed the Authority's key business risks which are relevant to our VFM conclusion;
- identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;

- considered the results of relevant work by the Authority, inspectorates and review agencies in relation to these risk areas.


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

We concluded that we did not need to carry out additional work for these risks as there was sufficient relevant work that had completed by the Authority, inspectorates and review agencies in relation to these risk areas.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
	<p>The systems and processes used by the Authority to manage effectively financial risks and opportunities, and the ability of the Authority to secure a stable financial position that enables it to continue to operate for the foreseeable future.</p>	<p>Throughout the year we have reviewed the Authority's budget and financial plans to ensure they accurately reflect the Authority's financial position. The Authority has robust budgetary control procedures in place and key variances are reviewed by senior management and reported to the Budget and Performance Panel.</p> <p>Once again, the Authority has had to make significant savings during the year as a result of Local Government funding cuts. The Authority has over performed on its savings target, achieving £513,000 of efficiencies and savings during 2013/14, and a further £277,000 at outturn. However additional savings of £260,000 will be required in 2014/15 and £1.0m in 2015/16.</p> <p>The Authority has developed and Implemented Savings Plans which cover a rolling three year period. As part of the annual budgeting process, after quarter 1, management review current year performance against savings targets and identify savings for future years. Individual services are required to identify new savings for future years, all of which is fed into the Medium Term Financial Strategy review in September.</p> <p>The Authority achieved a £277,000 under-spend against its revised budget for the year ended 31 March 2014 demonstrating it is able to secure a stable financial position that enables it to continue to operate for the foreseeable future.</p>

We have identified a number of specific VFM risks.

In all cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
	<p>The prioritisation of resources within tighter budgets, for example the achievement of cost reductions and improvements in efficiency and productivity.</p>	<p>The arrangements in place for identifying, implementing and monitoring savings and efficiency reviews were sufficient to ensure the Authority achieved its financial budget in 2013/14.</p> <p>The Council finalised the surrender of the Lancaster Market lease in May 2013. Through our discussions with management and review of related executive minutes, we obtained evidence that the Council has assessed and understood the implications of surrendering the lease from both a financial and VFM perspective. Management ensured that the transaction was concluded in an efficient manner.</p> <p>We have gained assurance throughout the audit process that the Authority has implemented appropriate measures to secure economy, efficiency and effectiveness in the Authority's use of resources.</p>

## Appendix 1: Key issues and recommendations

We have given each recommendation a risk rating and agreed what action management will need to take.

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

Priority rating for recommendations		
<p><b>1</b> <b>Priority one:</b> issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.</p>	<p><b>2</b> <b>Priority two:</b> issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.</p>	<p><b>3</b> <b>Priority three:</b> issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.</p>

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
1	<b>3</b>	<p><b>Bank Reconciliations</b></p> <p>As part of our audit of bank reconciliations, we were unable to assess whether the bank reconciliations tested had been prepared and reviewed in a timely manner. This was because the preparer and reviewer had not recorded the date of preparation and review respectively.</p> <p>Whilst the reconciliations tested had been accurately completed, to ensure alignment with best practice, reconciliations should be dated when signed as prepared and reviewed, to demonstrate that they have been completed in a timely manner.</p>	<p><b>Management response:</b></p> <p>Whilst all reconciliations had been reviewed and signed off, a number had not been dated.</p> <p>In future, all reconciliations will be signed and dated correctly.</p> <p><b>Officer Responsible:</b></p> <p>Financial Services Manager</p>



We have given each recommendation a risk rating and agreed what action management will need to take.

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
2	2	<p><b>Verification of Third Party Information</b></p> <p>Under the new arrangements for NNDR collection and distribution through the collection fund, the Authority has had to include a provision for appeals against NNDR valuations. The Authority has chosen to use an expert to assist them in calculating this estimate, Inform-CPI.</p> <p>Inform-CPI provided a report to the Authority which included their estimate of the appeals provision value, but this report did not set out any of the details of the assumptions or methodology that Inform-CPI had used to produce their estimate.</p> <p>When asked, Authority officers could not fully explain the basis for Inform-CPI's estimate. Following a number of request made by the Authority, evidence was provided to support the estimate however this took a significant amount of time and caused delays to the audit process.</p> <p><b>Recommendation</b></p> <p>Where the Authority engages a third party to provide information to be included within the financial statements it should ensure that that the methodology is fully understood and that it is possible to easily obtain evidence to support the balance, thus providing a strong audit trail.</p>	<p><b>Management response:</b></p> <p>Inform-CPI has been developing NNDR software systems alongside the Institute of Rating, Revenues and Valuation (IRRV) since 1999, and utilises the complete rating history of every heriditament that has existed in rating since 1990. Based on this background information, officers were happy that the estimates provided by Inform-CPI would be more accurate than those calculated in-house.</p> <p>Whilst officers understand and were able to explain the basis of the estimates, it was not possible to provide the exact data used to calculate them. This was because the estimates were produced from Inform-CPI's own software programme and due to commercial sensitivity were initially only prepared to provide a statement on the methodology used.</p> <p>Subsequent discussions resulted in further data being provided which was used to substantiate the calculations for the two particular appeals relating to the power stations.</p> <p>It should also be noted that the council relies on third parties to provide information in respect of the pension figures included within the financial statements. Officers are solely reliant on that information provided and would not realistically be able to develop a full understanding due to the complexities of actuarial valuations, which is a very specialist area.</p> <p>It should be noted that the basis of the appeals provision calculation was no different to that applied by officers in previous years. The only difference is that Inform-CPI are able to draw on a greater volume and more specific historical data associated with individual appeals nationally, thus enabling a more accurate estimate to be calculated.</p> <p>It is acknowledged, however, that unlike Inform-CPI, there is a well established audit framework for the Pension Fund to ensure evidence is available to auditors. In conclusion, from a management perspective, this recommendation has implications for future years' closure of accounts, and even more so if statutory completion timescales were to be brought forward.</p> <p><b>Officer Responsible:</b></p> <p>Financial Services Manager</p>

## Appendix 2: Follow up of prior year recommendations

The Authority has implemented all of the recommendations in our ISA 260 Report 2012/13.

This appendix summarises the progress made to implement the recommendations identified in our ISA 260 Report 2012/13 and re-iterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	1
Implemented in year or superseded	1
Remain outstanding (re-iterated below)	0

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at August 2014
1	3	<p><b>Budget Monitoring</b></p> <p>On a quarterly basis, the Council's Corporate Financial Monitoring plan should be presented to the Budget and Performance panel. This is presented to allow the panel to monitor current performance against budget and additionally, to inform decisions relating to budget setting for the next financial year.</p> <p>From our review of Budget and Performance panel meeting minutes, we identified one instance when this did not happen. Management has explained that whilst the monitoring report had been completed, it was unfortunately omitted from the Corporate Performance Monitoring update provided to the panel.</p> <p>There is a risk that if members don't receive timely financial information, they will not be able to make decisions in relation to the budget position.</p> <p>The Council should ensure that all relevant reports are presented to members.</p>	<p>The Financial Services Manager has already put in place measures to ensure that future reports are reported to the panel.</p> <p><b>Officer responsible:</b> Financial Services Manager</p> <p><b>Due date:</b> N/A</p>	<p>From our review of Budget and Performance panel meeting minutes, we have not identified any instances where this plan was not presented.</p> <p><b>Status:</b> Implemented.</p>

## Appendix 3: Follow up of 2010/11 outstanding recommendations

The Authority has implemented all of the recommendations in our ISA 260 Report 2010/11.

This appendix summarises the progress made to implement the recommendations identified in our ISA 260 Report 2010/11 and found to be still outstanding in our ISA 260 2011/12 and ISA 260 2012/13.

Number of recommendations that were:	
Included in original report	3
Implemented in year or superseded	3
Remain outstanding (re-iterated below)	0

No.	Risk	Issue, recommendation, Officer responsible and due date	Status as at September 2012 and 2013	Status as at August 2014
1	3	<p><b>System access rights to financial systems</b></p> <p>There is no periodic review of system access rights for financial systems. As a result there is a risk that employees have inappropriate access to the financial systems.</p> <p>Management should review the access rights to its financial systems on a periodic basis to ensure that access rights remain appropriate.</p> <p><b>Officer responsible:</b> Systems Support Accountant</p> <p><b>Due date:</b> November 2011</p>	<p>No further reviews of access rights have been undertaken during the year.</p> <p><b>Status:</b> Partially Implemented.</p>	<p>We have ascertained that a review of access rights has been undertaken during the year.</p> <p><b>Status:</b> Implemented.</p>

The Authority has implemented all of the recommendations in our ISA 260 Report 2010/11.

No.	Risk	Issue, recommendation, Officer responsible and due date	Status as at September 2013	Status as at August 2014
2	3	<p><b>Posting and authorising of journals</b>            From our controls testing of journals we discovered that Principal Accountants at the Authority are able to post and authorise their own journals.</p> <p>There should be segregation of duties between those that can post journals and those that can authorise them to ensure that journals are not incorrectly/inappropriately posted.</p> <p><b>Officer responsible:</b>            Accountancy Services Manager  <b>Due date:</b>            N/A</p>	<p>As issues relating to segregation of duties were once again identified as part of our 12/13 journals controls testing, we followed up the implementation of the recommended compensating control. However, testing confirmed that no formal sign off of monthly journal summaries is undertaken.</p> <p><b>Status:</b>            Outstanding</p>	<p>As part of our 13/14 journals controls testing, we have identified that the monthly journal report summaries have been formally reviewed and signed off by the Financial Services Manager.</p> <p><b>Status:</b>            Implemented.</p>

## Appendix 3: Follow up of 2010/11 outstanding recommendations (cont.)

The Authority has implemented all of the recommendations in our *ISA 260 Report 2010/11*.

No.	Risk	Issue, recommendation, Officer responsible and due date	Status as at September 2013	Status as at August 2014
3	3	<p><b>Physical verification of property, plant and equipment</b>            The Authority does not perform a formal annual physical verification of its plant and equipment to confirm existence of those assets. Property is typically verified through the asset valuation process.</p> <p>Management should introduce a process to ensure that its fixed asset records remain accurate.</p> <p><b>Officer responsible:</b>            Internal Audit Manager</p> <p><b>Due date:</b>            March 2012</p>	<p>The Council's Financial Services Manager is currently producing a standardised asset inventory template which will be rolled out across all services. This will be accompanied by written guidelines for each service area to adhere to and will ensure that the Council's asset inventories are up to date.</p> <p><b>Status:</b>            Partially Implemented.</p>	<p>Further progress on this issue had been put on hold, due to other work priorities, pending officers determining whether one of the Authority's current asset software packages could be utilised.</p> <p>Officers within accountancy and the Property Group are now taking this forward again. It should be noted that in terms of plant and equipment, of any significant value, e.g. refuse vehicles, the existence of those assets is verified through operational and supporting practices.</p> <p>The risk is therefore considered to be comparatively low, hence the prioritisation of this work.</p>

## Appendix 4: Audit differences

**No significant audit differences have been identified during our audit.**

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.

### **Corrected audit differences**

We are pleased to say that we have not identified any corrected audit differences during our audit work.

### **Uncorrected audit differences**

We are pleased to say that we have not identified any uncorrected audit differences during our audit work.

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

### Requirements

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

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

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

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

- Details of all relationships between the auditor and the client, its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the client, its directors and senior management and its affiliates, that the auditor considers may reasonably be thought to bear on the auditor’s objectivity and independence.
- The related safeguards that are in place.

- The total amount of fees that the auditor and the auditor’s network firms have charged to the client and its affiliates for the provision of services during the reporting period, analysed into appropriate categories, for example, statutory audit services, further audit services, tax advisory services and other non-audit services. For each category, the amounts of any future services which have been contracted or where a written proposal has been submitted are separately disclosed. We do this in our *Annual Audit Letter*.

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor’s professional judgement, the auditor is independent and the auditor’s objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor’s objectivity and independence may be compromised and explaining the actions which necessarily follow from his. These matters should be discussed with the Audit Committee.

Ethical Standards require us to communicate to those charged with governance in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on our independence and the objectivity of the Engagement Lead and the audit team.

### General procedures to safeguard independence and objectivity

KPMG’s reputation is built, in great part, upon the conduct of our professionals and their ability to deliver objective and independent advice and opinions. That integrity and objectivity underpins the work that KPMG performs and is important to the regulatory environments in which we operate. All partners and staff have an obligation to maintain the relevant level of required independence and to identify and evaluate circumstances and relationships that may impair that independence.

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

Acting as an auditor places specific obligations on the firm, partners and staff in order to demonstrate the firm's required independence. KPMG's policies and procedures regarding independence matters are detailed in the *Ethics and Independence Manual* ('the Manual'). The Manual sets out the overriding principles and summarises the policies and regulations which all partners and staff must adhere to in the area of professional conduct and in dealings with clients and others.

KPMG is committed to ensuring that all partners and staff are aware of these principles. To facilitate this, a hard copy of the Manual is provided to everyone annually. The Manual is divided into two parts. Part 1 sets out KPMG's ethics and independence policies which partners and staff must observe both in relation to their personal dealings and in relation to the professional services they provide. Part 2 of the Manual summarises the key risk management policies which partners and staff are required to follow when providing such services.

All partners and staff must understand the personal responsibilities they have towards complying with the policies outlined in the Manual and follow them at all times. To acknowledge understanding of and adherence to the policies set out in the Manual, all partners and staff are required to submit an annual ethics and independence confirmation. Failure to follow these policies can result in disciplinary action.

#### **Auditor declaration**

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





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