cutting through complexity

Report to those charged with governance (ISA 260) 2014/15

Lancaster City Council

August 2015

Appendix A

Contents

The contacts at KPMG in connection with this report are:

Timothy Cutler
Partner

KPMG LLP (UK)

Tel: 0161 246 4774
tim.cutler@kpmg.co.uk

Richard Lee
Senior Manager
KPMG LLP (UK)

Tel: 0161 246 4661
richard.lee@kpmg.co.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. The Audit Commission issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document 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 Timothy Cutler, 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, Trevor Rees (on 0161 246 4000, or by email to trevor.rees@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.

Section one

Introduction

This document summarises:

- **the key issues identified during our audit of the financial statements for the year ended 31 March 2015 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 2014/15 financial statements; and
- the work to support our 2014/15 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 2014/15*, presented to you in June 2015, set out the four stages of our financial statements audit process.

This report focuses on the third stage of the process: substantive procedures. Our on site work for this took place during April 2015 (interim audit) and July 2015 (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 2014/15* explained our risk-based approach to VFM work. We have now completed the work to support our 2014/15 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 2014/15 financial statements of the Authority.
- 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 Appendix 2.

Acknowledgements

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

Headlines

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

Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2015. We also anticipate reporting that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.
Audit adjustments	Our audit has identified one audit adjustment with a value of £1.9 million. The impact of this adjustment is to: ■ decrease the surplus on provision of services for the year by £1.9 million; and ■ decrease the net worth of the Authority as at 31 March 2015 by £1.9 million. There is no net impact on the General Fund and HRA as a result of this amendment. We have summarised the audit adjustment in Appendix 3. This has been corrected in the final version of the financial statements. We have raised a recommendation in relation to the matter highlighted above, which is summarised in Appendix 1.
Key financial statements audit risks	We identified one key financial statements audit risk in our 2014/15 External audit plan issued in June 2015 in relation to the national non-domestic rates appeals provision. We have worked with officers and performed work in relation to this key risk and our detailed findings are reported in section 3 of this report. We are satisfied that the Authority has appropriate arrangements in place to address the risks and issues that we have identified.

Headlines

Accounts production and audit process	The quality of the accounts and the supporting working papers has been maintained at a high standard in 2014/15, which assists with the delivery of an effective and efficient audit. As a result, the audit process has been completed within the planned timescales. The Authority has implemented the majority of the recommendations in our *ISA 260 Report 2013/14* relating to the financial statements.
Completion	At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas: ■ Review of the Annual Governance statement ■ Whole of Government Accounts review ■ A review of any post balance sheet events up to the date of signing our audit report. Before we can issue our opinion we require a signed management representation letter. 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.
VFM conclusion and risk areas	We identified one VFM risk in our External audit plan 2014/15 issued in June 2015 in relation to Savings Plans. We have worked with officers throughout the year to discuss this VFM risk and our detailed findings are reported in section 4 of this report. Following our preliminary assessment, we decided that no specific risk based work was required. 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 VFM conclusion by 30 September 2015.

Financial Statements
Proposed opinion and audit differences

Our audit has identified one audit adjustment.

The impact of this adjustments is to:

- **decrease the surplus on provision of services for the year by £1.9 million; and**
- **decrease the net worth of the Authority as at 31 March 2015 by £1.9 million.**

There is no net impact on the General Fund and HRA as a result of this amendment.

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2015.

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.

Our audit identified one significant audit difference, which is set out in Appendix 3. This will be adjusted in the final version of the financial statements.

The tables on the right illustrate the total impact of audit differences on the Authority's General Fund and Balance Sheet as at 31 March 2015.

There is no net impact on the General Fund and HRA as a result of this amendment.

Movements on the General Fund 2014/15

£m	Pre-audit	Post-audit	*Ref (App.3)*
Surplus on the provision of services	5,560	3,660	1.
Other Comprehensive Income and Expenditure	9,125	9125	
Adjustments between accounting basis & funding basis under Regulations	(14,684)	(12,784)	*1.*
Transfers to earmarked reserves	912	912	
Increase in General Fund and HRA	**913**	**913**	

Balance Sheet as at 31 March 2015

£m	Pre-audit	Post-audit	*Ref (App.3)*
Net worth	**124,951**	**123,051**	***1.***
General Fund	4,625	4,625	
Other usable reserves	18,401	18,401	
Unusable reserves	101,925	100,025	*1.*
Total reserves	**124,951**	**124,951**	

Financial Statements (continued)
Proposed opinion and audit differences

We anticipate issuing an unqualified audit opinion in relation to the Authority's financial statements by 30 September 2015.

The wording of the draft Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007

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 2014/15 ('the Code')*. The Authority will be addressing these in the final version of the accounts, where significant.

Annual Governance Statement

We have reviewed the draft 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.

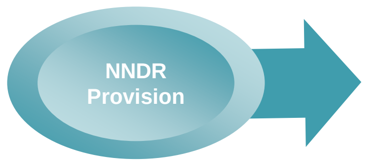
Financial Statements (continued)
Significant risks and key areas of audit focus

We have worked with the Authority throughout the year to discuss significant risks and key areas of audit focus

This section sets out our detailed findings on those risks

In our *External Audit Plan 2014/15*, presented to you in June 2015, we identified the significant risks affecting the Authority's 2014/15 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

The table below sets out our detailed findings for each of the risks that are specific to the Authority.

Significant audit risk	Issue	Findings
	Following the introduction of the Business Rates Retention Scheme in April 2013, local authorities are liable for the cost of successful business rates appeals, up to the level of the annual safety net. As a result, the Authority was required to recognise a provision within the 2013/14 financial statements which estimated the potential cost of outstanding appeals up until 31 March 2014. A similar provision will need to be calculated and recognised within the 2014/15 financial statements to accurately reflect any changes to existing appeals and consider any new appeals up until 31 March 2015. The calculation of the provision requires management to make significant assumptions and judgements, therefore there is a high level of estimation uncertainty in relation to this balance within the financial statements. Since the year end, we understand that the Authority has reached a settlement for two of the significant appeals relating to power stations. As such, the Authority will be able to include the actual impact of this settlement within the year end accounts, although the full financial impact is still to be determined.	The Authority has included a provision of £27.8 million for appeals against NNDR rateable valuations in the collection fund, with the Authority's share of this in the balance sheet being £11.1 million. As in the prior year, the vast majority of this provision (£23.7 million) relates to two power station sites. Post year-end, the Valuation Office Agency reached an agreement with the ratepayers on the following: - withdrawal of one of the two appeals; and - a lower rateable value for the remaining appeal. This settlement was provided to the Authority and used to calculate the related provision. We have reviewed the calculation of the provision relating to the power stations and found it to be an appropriate estimate and in line with CIPFA guidance. The Authority has used an expert (Analyse Local) to value the remaining appeals and have included a provision for £4.2 million. We have reviewed the detailed calculations and the method statement provided by Analyse Local, and we are satisfied with the basis of the NNDR provision included within the financial statements.

Financial Statements (continued)
Significant risks and key areas of audit focus (continued)

In our *External Audit Plan 2014/15* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. These risk areas were Management override of controls and the Fraud risk of revenue recognition.

The table below sets out the outcome of our audit procedures and assessment on these risk areas.

Areas of significant risk		Summary of findings
Management override of controls	Audit areas affected ■ All areas	Our audit methodology incorporates the risk of management override as a default significant risk. 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. 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.
Fraud risk of revenue recognition	Audit areas affected ■ None	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 2014/15 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.

Financial Statements (continued)
Accounts production and audit process

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

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

The Authority has implemented the majority of the recommendations in our *ISA 260 Report 2013/14.*

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
Accounting practices and financial reporting	The Authority has maintained the good quality of its financial reporting process. We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 2 July 2015. The accounts were signed by the Chief Officer (Resources) before the 30 June deadline.
Quality of supporting working papers	Our *Prepared by Client List* set out our working paper requirements for the audit. The quality of working papers provided was high and met our requirements.
Response to audit queries	Officers resolved the majority of audit queries in a reasonable time.

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 the majority of the recommendations in our *ISA 260 Report 2013/14*.

Appendix 2 provides further details.

Financial Statements (continued)
Completion

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 2015, 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 4 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 2014/15 financial statements.

VFM conclusion

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:

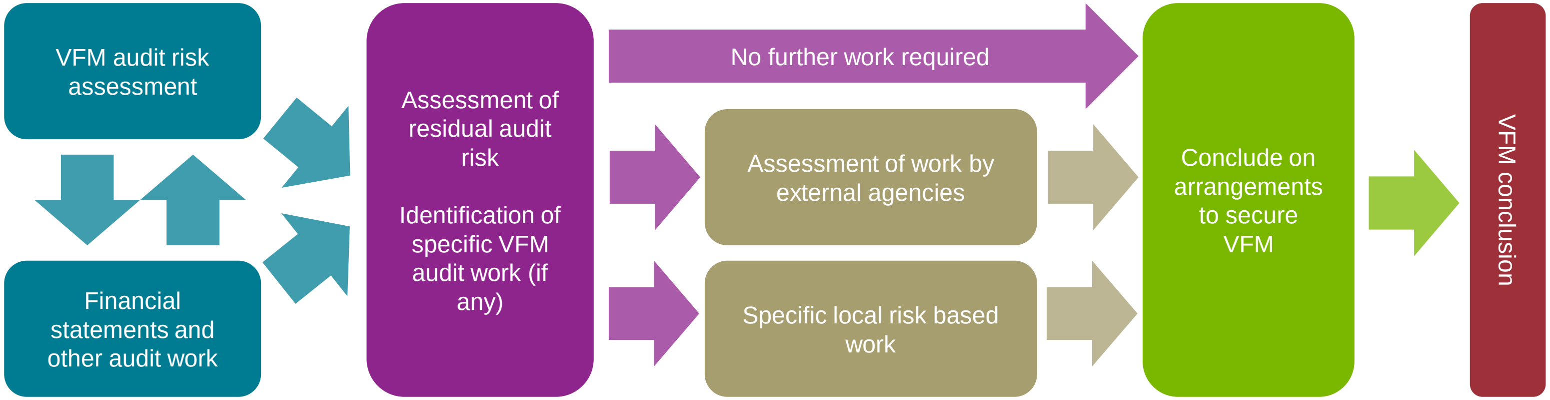
- securing financial resilience: looking at the Authority's financial governance, financial planning and financial control processes; and
- challenging how it secures economy, efficiency and effectiveness: looking at how the Authority is prioritising resources and improving efficiency and productivity.

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.

The following page includes further details of our VFM risk assessment

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	✓

Section four

Specific VFM risks

We have identified one specific VFM risk.

We are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to this risk area is 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

Key findings

Below we set out the findings in respect of the area 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 this risks as there was sufficient relevant work that had completed by the Authority, inspectorates and review agencies in relation to this risk area.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
	In recent years, the Authority has faced substantial budgetary pressures, and it has managed these through a combination of measures. More specifically, the Authority originally estimated it would need to make savings of £1m in 2015/16. It has now set a balanced budget for that year, albeit drawing £1m from balances. Furthermore, it now estimates it will need to find savings of £1.5m in 2016/17 and £2m in 2017/18. 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. Additionally, with the uncertainty around the political landscape, the direction of economic policy is unclear and therefore it is increasingly more challenging for authorities to accurately estimate future savings targets and financially plan for the medium term. This is relevant to both the financial resilience and economy, efficiency and effectiveness criteria of the VFM conclusion	The arrangements in place for identifying, implementing and monitoring savings and efficiency reviews were sufficient to ensure the Authority achieved its financial budget in 2014/15. The Authority achieved a £553,000 under-spend against its revised budget for the year ended 31 March 2015 demonstrating it is able to secure a stable financial position that enables it to continue to operate for the foreseeable future. We have gained assurance throughout the audit process that the Authority has implemented appropriate measures to secure economy, efficiency and effectiveness in its use of resources. Looking forward, whilst further efficiencies have been identified to help balance the 2015/16 budget, the Authority has relied on using £1m of balances as an interim measure. Furthermore, the likelihood is that the budget projections completed in March 2015 (identifying the £1.5m savings needed in 2016/17 and £2m in 2017/18) will worsen, in light of recent Government announcements. The Authority now needs to move swiftly to establish savings plans for the medium term to address the projected budget deficits.

Appendix 1: Key issues and recommendations

We have identified one recommendation as a result of our external audit in 2014/15.

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		
❶ ***Priority one***: 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.	❷ ***Priority two***: 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.	❸ ***Priority three***: 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.

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
1	❷	**Held for Sale (HFS) asset impairment** As part of the audit of HFS assets, it was found that the Lancaster Science Park Land was held at the same value as it had been in the previous year (£1.9m). Further investigation found that this asset had been impaired down to £1 during this year (to reflect the agreed sale value and HCA grant conditions), however this was omitted from the revaluation schedule and was therefore not reflected in the CIES or the HFS note. **Recommendation** The CIES and HFS note should be adjusted to reflect this impairment. In future years, at the time of accounts preparation, the finance team should confirm that its revaluations schedule agrees completely to all revaluation certificates held by Property Services. The finance team should also ensure that once any strategic decisions are made, any required amendments to asset carrying values are undertaken on a timely basis, rather than waiting until the year end closedown.	Management accept the recommendations and have already put in place procedures to ensure in-year valuation changes are actioned immediately, and more detailed reconciliations will be undertaken as part of the closedown process. **Responsible officer** – Financial Services Manager **Due Date** – Immediately.

Appendix 2: Follow up of prior year recommendations

One recommendation from the prior year remains outstanding.

We re-iterate the importance of this recommendation and recommend that this is implemented as a matter of urgency.

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2013/14* and re-iterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	2
Implemented in year or superseded	1
Remain outstanding (re-iterated below)	1

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at August 2015
1	2	**Verification of Third Party Information** 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. 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. 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. **Recommendation** 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.	**Officer Responsible:** Financial Services Manager	The Authority obtained the detailed calculations and methodology from the external expert to support the estimate. It is clear that management understood the expert's methodology and was able to support the basis of the provision. **Status:** Implemented

Appendix 2: Follow up of prior year recommendations

One recommendation from the prior year remains outstanding.

We re-iterate the importance of this recommendation and recommend that this is implemented as a matter of urgency.

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at August 2015
2	3	**Bank Reconciliations** 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. 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.	**Officer Responsible:** Financial Services Manager	We found that all reconciliations had been signed and dated but that a number had not been prepared or reviewed in a timely manner. **Status:** Outstanding

Appendix 3: Audit differences

This appendix sets out the audit difference identified during the audit of the 2014-15 financial statements.

This has been discussed with management and it is our understanding that it will be adjusted in the final version of the financial statements.

There is no net impact on the General Fund and HRA as a result of this amendment.

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.

Uncorrected audit differences

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

Corrected audit differences

Our audit identified one error in the financial statements, which was marginally below our materiality level. This has been discussed with management and it is our understanding that this will be adjusted in the final version of the financial statements. The error has been described in Appendix 1 and the adjustment required has been set out in the table below:

	Impact					
No.	Income and Expenditure Statement	Movement in Reserves Statement	Assets	Liabilities	Reserves	Basis of audit difference
1	Dr Other operating expenditure £1.9m	Cr Capital Adjustment Account (CAA) £1.9m	Cr Long term assets (this asset has subsequently been re-classified as an asset held for sale) £1.9m	-	Dr Unusable Reserves – CAA £1.9m	
	Dr £1.9m	**Cr £1.9m**	**Cr £1.9m**	**-**	**Dr £1.9m**	**Total impact of adjustments**

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

Appendix 4: Declaration of independence and objectivity

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

Requirements

Auditors appointed by Public Sector Audit Appointments Ltd 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 Public Sector Audit Appointments Ltd *Terms of Appointment* ('Public Sector Audit Appointments Ltd 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. Public Sector Audit Appointments Ltd 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.

Appendix 4: Declaration of independence and objectivity (continued)

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 2015, 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.

Appendix 5: KPMG Audit Quality Framework

We continually focus on delivering a high quality audit.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Appendix 5: KPMG Audit Quality Framework

We continually focus on delivering a high quality audit.

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

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

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

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

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

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

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

Our quality review results

Public Sector Audit Appointments Ltd publishes information on the quality of work provided by us (and all other firms) for audits undertaken on behalf of them (http://www.psaa.co.uk/audit-quality/principal-audits/kpmg-audit-quality/).

The latest Annual Regulatory Compliance and Quality Report showed that we are meeting the overall audit quality and regulatory compliance requirements.

cutting through complexity™