



Report to those charged with governance (ISA 260) 2015/16

Lancaster City Council

5 September 2016



Appendix A

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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 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 Tim 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, Andrew Sayers (on 0207 6948981, or by email to andrew.sayers@kpmg.co.uk). After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

This document summarises:

- The key issues identified during our audit of the financial statements for the year ended 31 March 2016 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 2015/16 financial statements; and
- The work to support our 2015/16 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 2015/16*, presented to you in June 2016, 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 July and August 2016.

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 2015/16 explained our risk-based approach to VFM work. We have now completed the work to support our 2015/16 VFM conclusion. This included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion;
- 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 2015/16 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.

Section two

Headlines

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

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

Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2016. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.
Audit adjustments	We are pleased to report that our audit has identified no audit adjustments. We have agreed a number of presentational changes to the Statement of Accounts with management.
Key financial statements audit risks	We review risks to the financial statements on an ongoing basis. We identified no significant risks specific to the Authority during 2015/16 with respect to the financial statements.
Accounts production and audit process	We received complete draft accounts on 27 June 2016 ahead of the DCLG deadline. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code. The quality of the accounts and the supporting working papers has been maintained at a high standard in 2015/16, 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 all of the recommendations in our ISA 260 Report 2014/15 relating to the financial statements.

Section two

Headlines (cont.)

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

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

VFM conclusion and risk areas	<p>We identified one VFM risk in our external audit plan 2015/16.</p> <ul style="list-style-type: none">— Financial resilience <p>Throughout the year we have made inquiries of management to understand how the Authority is addressing current and future financial challenges. Our detailed findings are reported in section 4 of this report. There are no matters of any significance arising as result of our audit work in these VFM risk areas.</p> <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 2015.</p>
Completion	<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">— 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.— Final checking of the financial statements and associated notes for consistency with the Narrative Report and arithmetic accuracy. <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> <p>We are currently considering a formal objection to the accounts which has been made by a local elector. Whilst we do not anticipate a delay in providing our audit opinion on the 2015/16 financial statements, we cannot provide our audit closure certificate until this matter is resolved.</p>

Proposed opinion and audit differences

We have not identified any issues in the course of the audit that are considered to be material.

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 following approval of the Statement of Accounts by the Audit Committee on 14 September 2016.

Audit differences

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

The final materiality (see Appendix 5 for more information on materiality) level for this year's audit was set at £2.5 million. Audit differences below £125k are not considered significant.

We did not identify any material misstatements. Consequently, there have been no changes made to the balance on the General Fund 'pre-audit' Statement of Accounts.

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 2015/16 ('the Code'). We understand that the Authority will be addressing these where significant.

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.

Significant audit risks



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 2015/16* 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.

Management override of controls

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

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

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

Fraud risk of revenue recognition

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

In our *External Audit Plan 2015/16* 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.

Section three – Financial statements

Significant risks and key areas of audit focus (cont.)

In our External Audit Plan 2015/16, presented to you in March 2016, we identified three additional areas of audit focus. These are not considered as significant risks but areas of importance where we would carry out some substantive audit procedures to ensure there is no risk of material misstatement.

We have now completed our testing. The table sets out our detailed findings for each area of audit focus.

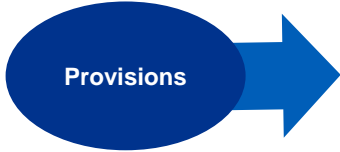

Other areas of audit focus	Issue	Findings
 <p>Pension costs and liabilities</p>	<p>The Authority had a net pension liability of £61.9m as at 31 March 2015 and £52.5m at 31 March 2016. The movements in this deficit are impacted by estimations made by the Authority's external actuarial specialists, Mercer.</p>	<p>We have reviewed and challenged the actuarial assumptions applied to the Authority's pension deficit as at 31 March 2016 using KPMG's own actuarial specialists.</p> <p>We have agreed all movements to the Authority's pension deficit to the actuarial report provider by Mercer, and performed testing over the Payroll inputs to those actuarial calculations, provided by the Authority.</p> <p>We have not identified any audit differences or presentational adjustments as a result of our work in this area.</p>
 <p>Staff costs</p>	<p>Staff costs represent a significant proportion of the Authority's expenditure base. The large number of transactions and changes to Payroll data that take place during the year indicates that staff costs should be given specific audit focus.</p>	<p>We have tested the controls around changes to Payroll data, which impact directly on staff costs recognised in the financial statements, to confirm they have been operating effectively during 2015/16. We did not identify any control deficiencies as a result of this work.</p> <p>We have not identified any audit differences or presentational adjustments as a result of our work in this area.</p>
 <p>Valuation of tangible fixed assets</p>	<p>There is an inherent uncertainty regarding the valuation of tangible fixed assets due to fluctuations and movements in the market value of the Authority's non-current assets.</p>	<p>We have reviewed the cyclical revaluation exercise completed by the Authority as at 31 March 2016, including an analysis of the assumptions made and the approach taken by the Authority's internal valuation specialist.</p> <p>We have confirmed that the valuation movements recognised within the Statement of Accounts are consistent with the findings of the Authority's valuation specialist and that these have been disclosed appropriately.</p> <p>We are satisfied that the recommendation made in 2014/15 in respect of property valuations has been implemented. Further details are included on page 18.</p>

Section three – Financial statements

Significant risks and key areas of audit focus (cont.)

In our External Audit Plan 2015/16, presented to you in March 2016, we identified three additional areas of audit focus. These are not considered as significant risks but areas of importance where we would carry out some substantive audit procedures to ensure there is no risk of material misstatement.

We have now completed our testing. The table sets out our detailed findings for each area of audit focus.

Other areas of audit focus	Issue	Findings
	<p>Provisions represent an area of management estimation and judgement in the accounts.</p> <p>It is important that all provisions are appropriately supported and that the balance included in the accounts represents the future obligations of the Authority.</p>	<p>At the year end, the Authority has included £14.5 million of provisions within the financial statements. Of this, £14.0 million relates to NNDR Business Rates appeals.</p> <p>The Authority continues to use Analyse Local (Inform CPI) as an external expert to support the level of this appeals provision. The methodology used by Analyse Local is consistent with that used in previous years and we are satisfied that management understand the approach taken and are able to challenge any anomalies.</p> <p>To gain assurance over the completeness of the provisions balance, we have reviewed minutes from meetings and made appropriate inquiries with management. We have not identified any issues from this work.</p>
	<p>The Authority operates a number of key financial systems which are used to populate or provide information for inclusion within the financial systems. It is important that these systems are well controlled and that the information produced is reliable and robust.</p>	<p>We have tested the key controls around the systems used to support the financial statements. This included testing general IT controls over the general ledger and reviewing the following processes; treasury management, accounts payable, NNDR, council tax and housing benefits systems.</p> <p>Our testing has not identified any significant weaknesses. We have however identified a number of lower priority improvement recommendations, details of which are set out on pages 15 to 17.</p>

Section three – Financial statements

Accounts production and audit process

The Authority has a well established and strong accounts production process. This operated well in 2015/16, and the standard of accounts and supporting working papers was high.

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

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 continues to maintain a strong financial reporting process and produce statements of accounts to a good standard. We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 27 June 2016. The Authority have made a small number of presentational changes to the accounts presented for audit, however there have been no changes which we consider to be fundamental.
Quality of supporting working papers	We issued our <i>Accounts Audit Protocol</i> including our required working papers for the audit in June 2016. The quality of working papers provided was high and fully met the standards specified in our <i>Accounts Audit Protocol</i> .
Response to audit queries	Officers resolved all audit queries in a timely manner.

Prior year recommendations

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

The Authority has implemented the prior year recommendations. Details are included in appendix 2 to this report.

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.

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 2016, 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 Chief Financial Officer for presentation to the Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

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

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

There are no other 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 2015/16 financial statements.

Objections to the accounts

We are currently considering a formal objection to the accounts which has been made by a local elector.

Whilst we do not anticipate a delay in providing our audit opinion on the 2015/16 financial statements, we cannot provide our audit closure certificate until this matter is resolved.

VFM Conclusion



Our VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. We follow a risk based approach to target audit effort on the areas of greatest audit risk.

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

Background

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

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

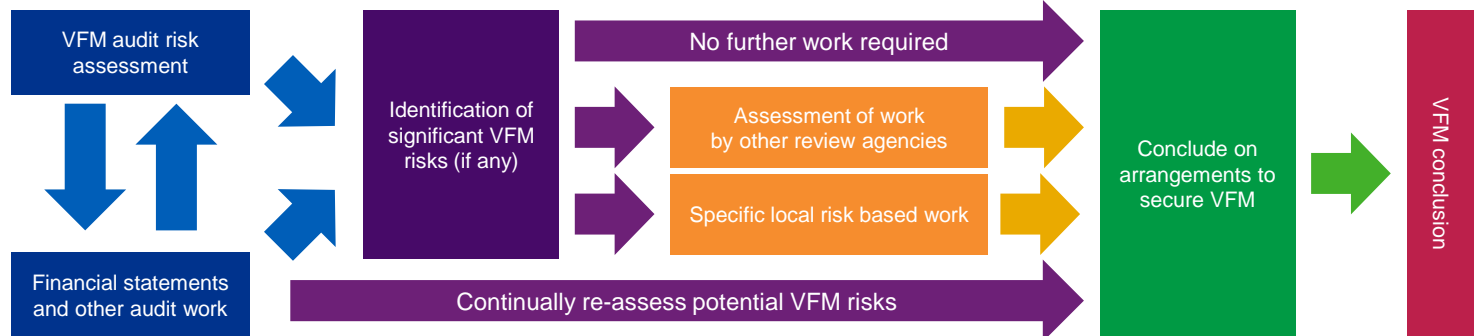
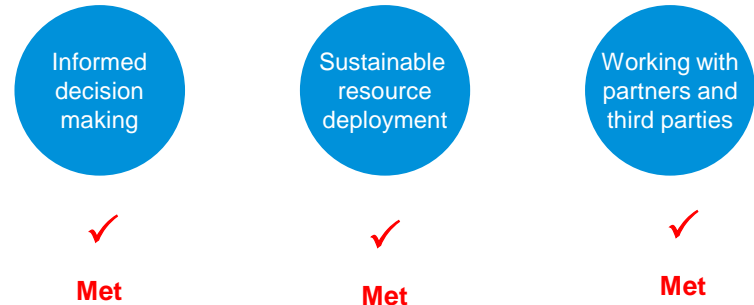
The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria.

These sub-criteria provide a focus to our VFM work at the Authority.

Conclusion

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

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



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 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; and

- Considered the results of relevant work by the Authority, inspectorates and review agencies in relation to these risk areas relevant to our VFM conclusion;

Key findings

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 this risk area as there was sufficient relevant work that had completed by the Authority in relation to this risk areas.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
	<p>The Authority continues to face substantial budgetary pressures – largely as a result of the significant cuts in Government funding as part of its programme of reductions in public sector spending. To date it has managed these through a combination of measures, mainly through efficiency savings. However the cumulative impact of these budget pressures results in a risk to the ongoing financial viability of the authority. There is a risk that savings plans are not achieved and it is increasingly more challenging for authorities to accurately estimate future savings targets and financially plan for the medium term.</p>	<p>The arrangements in place for identifying, implementing and monitoring savings and efficiency targets were sufficient to ensure the Authority achieved its financial budget in 2015/16.</p> <p>The Authority achieved a £331,000 under-spend against its revised budget for the year ended 31 March 2016 demonstrating it is able to secure a stable financial position that enables it to continue to operate for the foreseeable future.</p> <p>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.</p> <p>For 2016/17, savings and growth of £986k have been identified to help balance the budget. However this is in addition to increases in Council Tax of £5.00 per band D property (£2.45%). The Authority will now need to monitor this savings position carefully to ensure that the budget is achieved.</p> <p>As a result of these findings we have not been required to perform any specific risk based work in relation to the Authority's financial standing.</p>



Appendices

Appendix 1: Key issues and recommendations

Appendix 2: Follow up of prior year recommendations

Appendix 3: Audit differences

Appendix 4: Declaration of independence and objectivity

Appendix 5: Materiality and reporting of audit differences

Appendix 6: KPMG Audit Quality Framework

Appendix 1

Key issues and recommendations

This appendix sets out the recommendations arising from our 2015/16 audit work.

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

1	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.	2	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.	3	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.
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No.	Risk	Issue and recommendation	Management response/responsible officer/due date
1	3	<p>Fixed Asset Module to Northgate Housing Management System reconciliation</p> <p>From our testing we noted that the fixed asset module reconciliation to the housing management system is not formally documented.</p> <p>This is due to the historically low number of changes which occur during the year.</p> <p>There is a risk that if these systems are not formally reconciled on a periodic basis differences may not be identified on a timely basis and be more challenging to resolve at a later date.</p> <p>Recommendation</p> <p>We recommend that the Fixed Asset Module is reconciled to the Housing Management System on a monthly basis. All differences should be identified through this reconciliation process and appropriate action taken. The reconciliation should be formally documented and should include evidence of timely preparation and review.</p>	<p>Management response</p> <p>Reconciliations will be undertaken and documented on a monthly basis.</p> <p>Responsible officer and due date</p> <p>Peter Linsley Support Service Manager -Council Housing October 2016</p>

Appendix 1

Key issues and recommendations (cont.)

This appendix sets out the recommendations arising from our 2015/16 audit work.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
2	2	<p>General IT controls – user access</p> <p>To gain assurance over the Authority's financial ledger, we have performed a range of general IT controls.</p> <p>Our testing of user access rights identified that no periodic review is performed to ensure that staff have appropriate access rights to the general ledger. We also noted that for two individuals with access to the creditors module, authorisation limits or access rights had not been updated to reflect their revised job roles.</p> <p>We understand that all staff have enquiry access rights to the general ledger and that the only restrictions relate to finance and journal entry input.</p> <p>There is a risk that without regular review if a member of staff were to move from the finance team into another Council function their access rights may not be updated or amended. This could lead to unauthorised or inappropriate activity taking place.</p> <p>Recommendation</p> <p>We recommend that system access rights are reviewed on a periodic basis for all system users and amendments made if required.</p> <p>Evidence should be retained to demonstrate that this review has taken place on a regular and timely basis.</p>	<p>Management response</p> <p>Reviews will be undertaken and documented every 6 months.</p> <p>Responsible officer and due date</p> <p>Andrew Clarke Financial Services Manager October 2016</p>

Appendix 1

Key issues and recommendations (cont.)

This appendix sets out the recommendations arising from our 2015/16 audit work.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
3	2	<p>Declarations of interest</p> <p>As part of our work on related parties we reviewed ten declaration of interest forms relating to officers. Of these, nine had not been updated during 2015/16 and three had not been updated since 2010.</p> <p>This is due to the Authority's policy that officers are responsible for providing an update on any changes to circumstances.</p> <p>There is a risk that if declaration of interest forms are not updated by the Authority on a periodic basis it does full record of interests held by its Members and key officers. In addition, there is a risk that accounting disclosures in respect of related parties are not complete and the Authority may trade with organisation that it may wish not to due to conflicts of interest.</p> <p>Recommendation</p> <p>We recommend that all declaration of interest forms are updated by all key officers and members at least annually, and signed by the relevant individual to evidence that the document is complete and accurate record of their financial and other interests.</p>	<p>Management response</p> <p>An annual review will be undertaken to ensure all forms are updated and signed.</p> <p>Responsible officer and due date</p> <p>Deborah Chambers Democratic Services Manager January 2017</p>

Appendix 2

Follow up of prior year recommendations

The Authority has implemented all of the recommendations in our ISA 260 Report 2014/15.

This appendix summarises the progress made to implement the recommendations identified in our ISA 260 Report 2014/15 and re-iterates any recommendations still outstanding.

Number of recommendations that were:

Included in original report	2
Implemented in year or superseded	2
Remain outstanding (re-iterated below)	0

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at August 2016
1	2	<p>Held for Sale (HFS) asset impairment</p> <p>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.</p> <p>Recommendation</p> <p>The CIES and HFS note should be adjusted to reflect this impairment.</p> <p>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.</p> <p>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.</p>	<p>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.</p> <p>Responsible officer Financial Services Manager</p> <p>Due Date Immediately.</p>	<p>Implemented</p> <p>We have confirmed that all valuation movements included in the accounts agree to revaluation certificates held by Property Services.</p>

Appendix 2

Follow up of prior year recommendations (cont.)

The Authority has implemented all of the recommendations in our *ISA 260 Report 2014/15*.

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at August 2016
2	3	<p>Bank Reconciliations</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>Officer Responsible</p> <p>Financial Services Manager (this is an outstanding recommendation is from our 2013/14 audit)</p>	<p>Implemented</p> <p>Our testing has not found any issues in respect of bank reconciliation preparation and sign off.</p>

Appendix 3

Audit differences

This appendix sets out the audit differences.

The financial statements have been amended for all of the errors identified through the audit process.

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

We are pleased to report that there were no audit differences which were required to be corrected by management as a result of our audit.

Presentational issues

We identified a number of presentational and classification issues during our audit. This included amendments to:

- Collection Fund and Housing Revenue Account
- Grant income disclosures
- Officer remuneration disclosures
- Financial liabilities / instruments
- Accounting policies

These amendments have all been made by the Authority to the draft statement of accounts.

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.

Declaration of independence and objectivity (cont.)

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 Council for the financial year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and Lancaster City Council 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.

Materiality and reporting of audit differences

For 2015/16 our materiality is £2.5 million for the Authority's accounts.

We have reported all audit differences over £125,000.

Materiality

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

- Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.
- Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.
- Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We used the same planning materiality reported in our External Audit Plan 2015/16, presented to you in June 2016.

Materiality for the Authority's accounts was set at £2.5 million which equates to around 1.96% percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit Committee

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

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

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

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £125,000 for the Authority.

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

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. Andy Smith, 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.



KPMG Audit quality framework (cont.)

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 behaviours in the performance of effective and efficient audits. The key behaviours 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.psa.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.



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