



GOVERNMENT

Report to those charged with governance (ISA 260) 2009/10

Lancaster City Council

September 2010

AUDIT

Contents

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document.

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

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Kevin Wharton, who is the engagement lead for the Authority (telephone 0161 246 4281, email kevin.wharton@kpmg.co.uk) who will try to resolve your complaint. In the second instance you should contact Trevor Rees who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Investigation Officer, Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR or by email to complaints@audit-commission.gov.uk. Their telephone number is 0844 798 3131, textphone (minicom) 020 7630 0421.

Scope of this report

This report summarises:

- the key issues identified during our audit of Lancaster City Council's ('the Authority's') financial statements for the year ended 31 March 2010; and
- our assessment of the Authority's arrangements to secure value for money in its use of resources.

Financial Statements

The table below summarises the key findings from our work to date in relation to the financial statements audit. Section two of this document provides further details.

Proposed opinion	We anticipate issuing an unqualified audit opinion by 30 September 2010. We will also report that the wording of your Annual Governance Statement accords with our understanding of the Authority.	Critical accounting matters	We have worked with officers throughout the year to discuss specific risk areas. The Authority has addressed the issues appropriately.
Accounts production and audit process	<p>We have noted that the quality of the accounts and the supporting working papers continues to be high. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales.</p> <p>The Authority has implemented or is in the process of implementing all of the recommendations raised in 2008/09 relating to the financial statements, use of resources and the investment strategy and arrangements.</p>	Audit differences	<p>No audit differences have been identified during the course of our audit work.</p> <p>We have recommended a number of small presentational amendments to the financial statements to management.</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">• A review of the final financial statements for typographical errors and to ensure that they cast, cross reference and comply with all disclosure requirements. <p>Before we can issue our opinion we require a signed management representation letter. A draft letter is provided in Appendix G.</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>

Use of Resources

The table below summarises the key findings from our assessment of the Authority's arrangements to secure value for money in its use of resources.

Our findings are detailed in section three of this report.

Proposed opinion	We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.
Use of resources assessment	<p>Following the change in government, the use of resources assessment at local authorities ceased with immediate effect in May 2010.</p> <p>The Authority will therefore not receive scores in respect of the 2010 assessment.</p> <p>We have however done sufficient work to allow us to form an opinion on the Authority's value for money arrangements.</p> <p>In 2008/09 we identified that the Authority's arrangements in relation to its workforce planning needed strengthening. The work we have undertaken for the 2009/10 conclusion has identified that the Authority's arrangements have progressed well in this area. The Authority is now able to demonstrate that its workforce strategy is being linked in with the Council's overall medium and longer term strategies and structures. These developments continue and we will review progress at appropriate stages in 2010/11.</p> <p>The Authority's performance in relation to its use of natural resources was particularly strong. There is a clear strategy in place, with innovative approaches to implementing the strategy being used.</p> <p>The Authority has also made significant progress in linking its resource allocation to its priorities. This has made balancing the 2010/11 budget a much smoother process.</p>

Use of resources assessment (continued)	Given the Government's plan to reduce spending it is expected that the focus in future years will be around financial resilience. We have highlighted in section three some areas for development.
Specific use of resources risks	We did not identify any additional specific use of resources risks in our audit plan. Workforce planning arrangements remained the focus of our use of resources opinion work.

Exercise of other powers

We have a duty under section 8 of the Audit Commission Act 1998 to consider whether, in the public interest, to report on any matter that comes to our attention in order for it to be brought to the attention of the public. In addition we have a range of other powers under the 1998 Act.

No issues have arisen that have required us to issue a report in the public interest.

Certificate

We are required to certify that we have completed the audit in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice. If there are any circumstances under which we cannot issue a certificate, then we are required to report them to you and to issue a draft opinion on the financial statements.

We have had two issues raised with us from electors within the local authority area. One of these issues has been concluded and one is currently ongoing. This matter is unlikely to be material to the financial statements, however, it will require resolution before the audit certificate can be issued.

Acknowledgements

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

Introduction

We have substantially completed our work on the 2009/10 financial statements.

We anticipate issuing an unqualified audit opinion by 30 September 2010.

The Authority's and our responsibilities

Lancaster City Council is responsible for having effective systems of internal control to ensure the regularity and lawfulness of transactions, to maintain proper accounting records and to prepare financial statements that give a true and fair view of its financial position and its expenditure and income. It is also responsible for preparing and publishing an Annual Governance Statement with its financial statements.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

The Audit Commission's Code of Audit Practice requires us to summarise the work we have carried out to discharge our statutory audit responsibilities together with any governance issues identified and we report to those charged with governance (in this case the Audit Committee) at the time they are considering the financial statements.

We are also required to comply with International Standard on Auditing (ISA) 260 which sets out our responsibilities for communicating with those charged with governance.

This report meets both of these requirements.

Introduction

Our audit of the financial statements can be split into four phases:



This report focuses on the final two stages: substantive procedures and completion. It also includes any findings in respect of our control evaluation that we have to report.

Substantive Procedures

Our on-site final accounts visit took place between 19 July and 30 July. During these 2 weeks, we carried out the following work:

Substantive Procedures

- Planning and performing substantive audit procedures
- Concluding on critical accounting matters
- Identifying audit adjustments
- Reviewing the Annual Governance Statement

We have substantially completed our audit of the Authority's 2009/10 financial statements.

There is one area where our work is continuing:

- A review of the final financial statements for typographical errors and to ensure that they cast, cross reference and comply with all disclosure requirements.

Completion

We are now in the final phase of the audit. Some aspects are discharged through this report:

Completion

- Declaring our independence and objectivity
- Obtaining management representations
- Reporting matters of governance interest
- Forming our audit opinion

We anticipate issuing an unqualified audit opinion by 30 September 2010.

Accounts production and audit process

We have noted that the quality of the accounts and the supporting working papers has continued to be high.

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

The Authority has implemented or is in the process of implementing all of the recommendations raised in 2008/09.

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

Accounts production and audit process

ISA 260 requires us to communicate to you our views about the qualitative aspects of the Authority's accounting practices and financial reporting.

We have, therefore, 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	<p>The Authority has strong financial reporting processes and quality checks in place to assist in the preparation of the financial statements.</p> <p>We consider that accounting practices are appropriate.</p>
Completeness of draft accounts	<p>We received a complete set of draft accounts on 30 June 2010. The Authority made a number of amendments of a presentational nature following the Audit Committee meeting when the draft financial statements were discussed.</p> <p>In addition, we have proposed a small number of presentational amendments, which management are making where this improves the readability of the accounts.</p>

Element	Commentary
Quality of supporting working papers	<p>Our Accounts Audit Protocol, which we issued on 14 June and discussed with the Accountancy Services Manager set out our working paper requirements for the audit.</p> <p>High quality working papers were provided and met the standards specified in our Accounts Audit Protocol.</p>
Response to audit queries	<p>All additional audit queries were resolved in a reasonable time.</p>

Prior year recommendations

The Authority has implemented or is in the process of implementing all of the recommendations raised in 2008/09 relating to the financial statements, use of resources and the investment strategy and arrangements.

Appendix D provides further details.

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 in June 2007; and
- it is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

Critical accounting matters

We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.

Work completed

- In our *Financial Statements Audit Plan 2009/10* we identified the key risks affecting the Authority's 2009/10 financial statements.
- We have now completed our testing of these areas and set out our final evaluation following our substantive work.



Key findings

- The table below sets out our detailed findings for each risk.

Key audit risk	Issue	Findings
Valuation of Investments	<p>The Authority had £6million invested in the Icelandic banks that collapsed in October 2008. As a result, there is a risk that the Authority could lose some, if not all, of the money it invested. The valuation in the financial statements of the investments held in the Icelandic banks could therefore be mis-stated if appropriate provisions are not made.</p> <p>In addition, if appropriate provisions are not made reserves could be adversely impacted at a later date, if monies are not recovered.</p>	<p>We have assessed the Authority's valuation assumptions for the Icelandic bank investments for appropriateness in light of CIPFA's latest available guidance. The current carrying value is £3.094m, representing the original investment, plus accrued interest of £0.692m, less repayment in respect of KSF (£0.717m) and impairment of £2.881m. The CIPFA guidance provides a best and worst case scenario of assumptions. The Authority has used assumptions midway between these. This is reasonable given the uncertainties.</p> <p>In addition, we have reviewed the Authority's progress in implementing the recommendations we raised in 2008/09 following the work we undertook on the Icelandic investments. The full results of this are recorded in Appendix D.</p> <p>Overall, we are satisfied with the Authority's progress in implementing our recommendations, however, the Internal Audit review should be completed as soon as is appropriate and practicable.</p> <p>We have reviewed third party confirmations for valuations of other investments held by Authority to ensure that investment values have been correctly recorded in the financial statements.</p> <p>In addition, we have reviewed the Authority's processes for identifying investments which may require provision. We are satisfied that the other investments are not materially mis-stated.</p>

Critical accounting matters (continued)

The Authority's work on IFRS is ongoing. We plan to undertake a review of the restated 2009/10 balances in the following months.

Key audit risk	Issue	Findings
 <p>Contingent liabilities</p>	<p>The contingent liabilities disclosed in the financial statements in 2008/09 could be financially significant if they were to crystallise. Therefore, if the Authority does not reflect the latest position in relation to these events the financial statements could be significantly misstated.</p>	<p>During the interim and final phases of our audit we have obtained an update from the Monitoring Officer and the s151 officer to review the situation in respect of Luneside East.</p> <p>We are satisfied that this remains a contingent liability for the 31 March 2010. In addition, the Authority has set aside monies in its reserves to protect itself from a financial risk perspective.</p>
 <p>Implementation of IFRS</p>	<p>Authorities are required to report under IFRS for the first time in 2010/11. The 2009/10 financial statements will need to be converted to IFRS to form the comparative period. Therefore, the opening IFRS balance sheet date was 1 April 2009. It is important that the Authority continues to work towards delivery of its IFRS project plan in order to ensure future compliance with IFRS.</p>	<p>We have held discussions with management during the year which has enabled us to review the progress being made by the Authority.</p> <p>We have advised management and provided guidance to assist in ensuring that the convergence process runs smoothly.</p> <p>The Authority does still have some work to do in terms of bringing Members' knowledge up to date on the impact that IFRS will have on the Authority and its financial statements.</p> <p>We have been informed that the Authority is progressing well with each of the key IFRS areas (for example, leases, component accounting, group accounts and employee benefits). At this stage we have not been provided with any working papers to review for these areas but we hope to be able to complete an audit of the re-stated balance sheet over the coming months, in advance of the 2010/11 year end to provide management with assurance in advance of the full year end audit.</p>

Audit commentary – pension liabilities

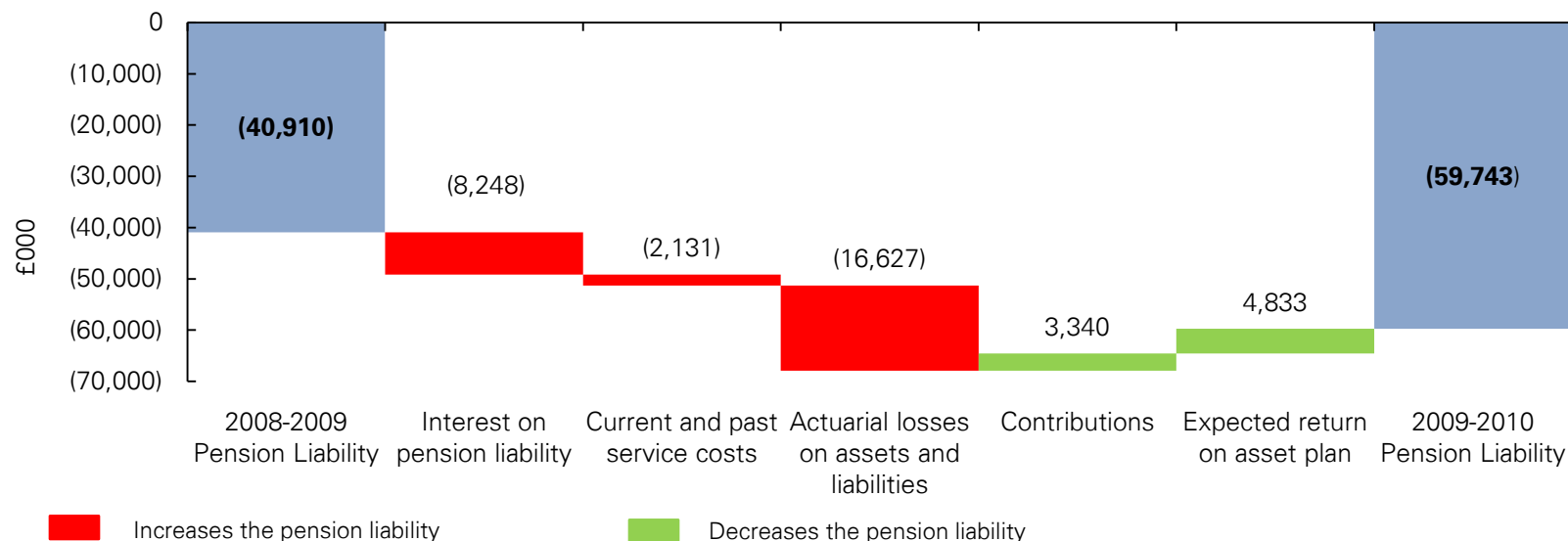
There were significant movements in the Authority's pension liabilities. This was largely due to a change in assumptions used by the actuary to estimate the liabilities and also the performance of the capital markets affecting the pension assets.

In addition, following the balance sheet date the Government announced a change to pensions, required authorities to disclose a post balance sheet event disclosure.

Members will have noticed that there has been a significant increase in the pension liabilities disclosed in the Authority's balance sheet from 2008/09 to 2009/10. This is consistent with other pension funds around the country.

Below we have provided an analysis of the pension liability movement to aid Members' understanding of the reasons for this:

From this analysis it can be seen that the largest change in the pension liability is due to the actuarial losses on the pension scheme. There was an actuarial loss on the liabilities of £36.9 million, which was partially offset by a gain of £20.2 million on the pension assets. The main reason for the change in the pension liability is because the actuary changed the assumptions it uses to estimate the pension fund liabilities. For example, people living longer, a lower discount rate and increased inflation rates.



Government announcement on pension increases

The Government has, however, recently announced that the basis upon which pensions increase will, in the future, be based on the Consumer Price Index (CPI) as opposed to the Retail Price Index (RPI). As CPI is typically lower than RPI, this is expected to have a positive impact upon pension scheme liabilities.

As a result of this announcement, the Authority has disclosed a post balance sheet event in its notes to the financial statements. This is considered to be a 'non-adjusting event' under the relevant financial reporting standard (FRS 21). This means that the balance sheet pension liability for 2009/10 has not been changed to reflect this announcement as the announcement was made after the balance sheet date. However, disclosure has been made to inform users of the potential future implications.

Audit differences

We have identified no issues in the course of the audit that are considered to be material.

Work completed

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.

Key findings

We did not identify any material misstatements.

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 the United Kingdom 2009: A Statement of Recommended Practice* ('SORP'). We understand that the Authority will be addressing these where significant or impacting on the readability of the accounts.

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 2010, we confirm that there were no relationships between KPMG LLP and Lancaster City Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix F 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 included a copy of a representation letter as Appendix G. We are required to obtain this prior to signing our audit opinion.

Other matters

ISA 260 requires us to communicate "audit matters of governance interest that arise from the audit of the financial statements" to you which includes:

- material weaknesses in internal control identified during the audit;
- matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. issues relating to fraud, compliance with laws and regulations, subsequent events etc); and
- other audit matters of governance interest.

There are no others matters which we wish to draw to your

attention.

Opinion

We anticipate issuing an unqualified audit opinion by 30 September 2010.

Our proposed opinion on the financial statements is presented in Appendix A

Summary

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

The Authority's and our responsibilities

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources and regularly reviewing their adequacy and effectiveness.

We are required to conclude whether the Authority has adequate arrangements in place to ensure effective use of its resources. We refer to this as the 'value for money (VFM) conclusion'.

Introduction

Our assessment previously drew mainly on the findings from the use of resources assessment (UoR) framework, as the specified criteria for the VFM conclusion were the same as the UoR Key Lines of Enquiry (KLoE).

In May 2010 the new government announced that the Comprehensive Area Assessment (CAA) would be abolished. The Audit Commission subsequently confirmed that work related to CAA should cease with immediate effect. This includes work for UoR assessments at local authorities.

However, there is no change to the requirement in the statutory Code of Audit Practice for auditors to issue a VFM conclusion.

Findings from VFM work

At the time of the announcement, the vast majority of UoR work for 2010 had already been completed and this therefore informed our 2009/10 VFM conclusion.

We have provided detailed feedback on the work undertaken to the Corporate Director (Finance and Performance) and the s151 officer. The key message is that the Authority has met each of the VFM criteria, as can be seen from the table, following improvements made to the Authority's workforce planning arrangements.

Going forward we expect that the focus of our work will be on financial resilience, given the anticipated cuts in Government spending. Some areas for development in readiness for this have been identified through our use of resources work.

The Authority should take advantage of opportunities to further develop its existing sensitivity planning arrangements and scenario planning looking at the extremes of worst and best case scenarios.

Conclusion

We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. Our proposed conclusion is set out in Appendix B.

VFM criterion	Met
Managing finances	
Financial planning	✓
Understanding costs and achieving efficiencies	✓
Financial reporting	✓
Governing the business	
Commissioning and procurement	✓
Data quality and use of information	✓
Governance	✓
Risk management and internal control	✓
Managing resources	
Use of natural resources	✓
Strategic asset management	✓
Workforce planning	✓

Appendix A: Proposed Opinion on the Financial Statements

Our opinion states whether the accounting statements and related notes give a true and fair view of the financial position of the Authority and its income and expenditure for the year.

We define what we mean by 'accounting statements'.

Independent auditors' report to the Members of Lancaster City Council

Opinion on the accounting statements

We have audited the accounting statements and related notes of Lancaster City Council for the year ended 31 March 2010 under the Audit Commission Act 1998. The accounting statements comprise the Lancaster City Council Income and Expenditure Account, the Statement of Movement on the General Fund Balance, the Balance Sheet, the Statement of Total Recognised Gains and Losses, the Cash Flow Statement, the Housing Revenue Account Income and Expenditure Account, the Statement of Movement on the Housing Revenue Account and the Collection Fund. The accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to Lancaster City Council, as a body, in accordance with Part II of the Audit Commission Act 1998. Our audit work has been undertaken so that we might state to Lancaster City Council, as a body, those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than Lancaster City Council, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Responsible Financial Officer and auditors

The Responsible Financial Officer's responsibilities for preparing the financial statements in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009 are set out in the Statement of Responsibilities for the Statement of Accounts.

Our responsibility is to audit the accounting statements and related notes in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the accounting statements and related notes give a true and fair view, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009, of:

- the financial position of the Authority and its income and expenditure for the year.

We review whether the governance statement reflects compliance with 'Delivering Good Governance in Local Government: A Framework' published by CIPFA/SOLACE in June 2007. We report if it does not comply with proper practices specified by CIPFA/SOLACE or if the statement is misleading or inconsistent with other information we are aware of from our audit of the financial statements. We are not required to consider, nor have we considered, whether the governance statement covers all risks and controls. Neither are we required to form an opinion on the effectiveness of the Authority's corporate governance procedures or its risk and control procedures.

We read other information published with the accounting statements and related notes and consider whether it is consistent with the audited accounting statements and related notes. This other information comprises the Explanatory Foreword and the content of the Annual Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounting statements and related notes. Our responsibilities do not extend to any other information.

Appendix A: Proposed Opinion on the Financial Statements (continued)

Our proposed opinion is unqualified.

There are no expected modifications to the auditors' report.

Basis of audit opinion

We conducted our audit in accordance with the Audit Commission Act 1998, the Code of Audit Practice issued by the Audit Commission and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounting statements and related notes. It also includes an assessment of the significant estimates and judgments made by the Authority in the preparation of the accounting statements and related notes, and of whether the accounting policies are appropriate to the Authority's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounting statements and related notes are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounting statements and related notes.

Opinion

In our opinion:

- The accounting statements and related notes give a true and fair view, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009, of the financial position of the Authority as at 31 March 2010 and its income and expenditure for the year then ended.

Kevin Wharton (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

St James' Square

Manchester

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Appendix B: Proposed value for money conclusion

Our proposed value for money conclusion is unqualified.

Conclusion on arrangements for securing economy, efficiency and effectiveness in the use of resources

Authority's Responsibilities

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance and regularly to review the adequacy and effectiveness of these arrangements.

Auditors' Responsibilities

We are required by the Audit Commission Act 1998 to be satisfied that proper arrangements have been made by the Authority for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires us to report to you our conclusion in relation to proper arrangements, having regard to relevant criteria specified by the Audit Commission for principal local authorities. We report if significant matters have come to our attention which prevent us from concluding that the Authority has made such proper arrangements. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Conclusion

We have undertaken our audit in accordance with the Code of Audit Practice. Having regard to the criteria for principal local authorities specified by the Audit Commission and published in May 2008 and updated in February 2009, we are satisfied that, in all significant respects, Lancaster City Council made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2010.

Kevin Wharton (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

St James' Square

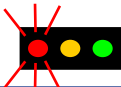


Manchester

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Appendix C: Recommendations

We have not raised any recommendations that we need to bring to the attention of the Audit Committee.

We give any recommendations we make a risk rating (as explained below) and agreed what action management will need to take. We follow up any recommendations made in the following year. We have not identified any recommendations during the course of our 2009/10 final accounts audit.

Priority rating for recommendation		
<p>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.</p> 	<p>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.</p> 	<p>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.</p> 

Appendix D: Follow-up of prior year recommendations

We raised a number of recommendations in 2008/09. These mainly related to use of resources and the Icelandic banks.

We have reviewed the Authority's status in implementing these recommendations.

All of the recommendations have either been implemented or are going through ongoing implementation.

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2008/09* and re-iterates any recommendations that are still outstanding.

Number of recommendations that were:		
Included in original report	Implemented/ongoing in year or superseded	Remain outstanding (re-iterated below)
4 (8 including Icelandic banks)	4 (8 including Icelandic banks)	0 (0 including Icelandic banks)

No.	Priority	Recommendation	Officer Responsible and Due Date	Status
1	2	Use of Resources – information collation The Authority is developing a system of knowledge capture for the next use of resources assessment. The Authority should make effective use of this system.	Corporate Director (Finance & Performance) January 2010	Implemented The requirement for a Use of Resources Assessment has been removed. Therefore this recommendation is not relevant now. However, for the work that we have undertaken on Use of Resources, there was clear improvement in the information collected and shared with us.

Appendix D: Follow-up of prior year recommendations (continued)

We raised a number of recommendations in 2008/09. These mainly related to use of resources and the Icelandic banks.

We have reviewed the Authority's status in implementing these recommendations.

All of the recommendations have either been implemented or are going through ongoing implementation.

No.	Priority	Recommendation	Officer Responsible and Due Date	Status
2	1	<p>Workforce planning</p> <p>The Authority's commitment to the fair pay project during 2008/09, coupled with high turnover of staff within the Human Resources section, has resulted in there being limited capacity in developing the Authority's workforce planning.</p> <p>Particular areas requiring further development are:</p> <ul style="list-style-type: none"> • linking service workforce planning to strategic plans, in both the medium and longer term; • planning for future skills gaps; • the Authority's approach to equality and diversity; and • demonstrating the Authority is an employer of choice. 	Chief Executive June 2010	<p>Partially Implemented</p> <p>The Authority has made significant progress in addressing its issues in respect of work force planning.</p> <p>There is now a clearer link between strategic plans and workforce planning, as well as planning for any future gaps in skills. We recognise that work in this area is still ongoing</p> <p>The Authority has been able to demonstrate that it is taking action to be an employer of choice.</p> <p>Equality and diversity practices remain in the early stages of development.</p>
2	2	<p>Allocation of resources</p> <p>The Authority faces significant financial pressures in the near future. The Authority is currently undertaking a review of its existing budget allocation across key priorities and objectives.</p> <p>In order for the Authority to achieve the budget realignment which is required to secure financial balance in 2009/10 onwards this review should be completed and necessary actions taken.</p>	Corporate Director (Finance & Performance) March 2010	<p>Implemented</p> <p>The Authority has reviewed its budget allocation across key priorities and objectives. This was much improved from the 2009/10 budget setting process.</p> <p>It now has a good basis on which to maintain regular reviews of its allocation of resources across corporate objectives and priorities, to inform future budget setting and support financial resilience.</p>

Appendix D: Follow-up of prior year recommendations (continued)

<p>We raised a number of recommendations in 2008/09. These mainly related to use of resources and the Icelandic banks.</p> <p>We have reviewed the Authority's status in implementing these recommendations.</p> <p>All of the recommendations have either been implemented or are going through ongoing implementation.</p>	No.	Priority	Recommendation	Officer Responsible and Due Date	Status
	4	2	<p>Building control account – financial performance</p> <p>There is a requirement under the Building (Local Authority Charges) Regulations 1998 for the Authority to ensure that the income received from its charges fully recover the cost of carrying out its building control functions over a rolling three year accounting period. However, for the three year period to 31 March 2009, the Authority has a deficit position, therefore breaching the Regulations. Given the current economic position, there is an increased risk to the Authority of further deficits if the position is not monitored and managed closely.</p> <p>The Authority should monitor its plan to address this deficit closely and take action as necessary to ensure that this deficit position is returned to a break-even or surplus position.</p>	<p>Head of Planning Services</p> <p>December 2009</p>	<p>Partially Implemented</p> <p>The Building Regulations Control account still has a deficit for the three year period to 31 March 2010.</p> <p>The Authority has plans to address this deficit going forward. There have been a number of redundancies in this area in March 2010 in order to reduce the costs associated with delivering this service.</p> <p>There were also changes to the Building (Local Authority Charges) Regulations taking effective at 1 April 2010 which make it easier for the Authority to vary the rates it charges during the year in order to tackle the deficit.</p>
	5	N/A	<p>Icelandic banks – Internal Audit review</p> <p>Internal Audit should undertake a comprehensive review of the treasury management function and its activities on an annual basis and should report its findings to the Audit Committee.</p>	<p>Head of Financial Services & Internal Audit</p> <p>March 2011</p>	<p>Partially implemented</p> <p>Internal Audit undertook a review of the activities under the previous treasury strategy in June 2010. The follow up audit, in August, resulted in substantial assurance being given over the system.</p> <p>Internal Audit are due to undertake a review of the new strategy and activities in the next 12 months. This will allow them to assess whether the new strategy is appropriate and is being implemented correctly. Internal Audit should undertake this review as soon as is practicable.</p>

Appendix D: Follow-up of prior year recommendations (continued)

<p>We raised a number of recommendations in 2008/09. These mainly related to use of resources and the Icelandic banks.</p> <p>We have reviewed the Authority's status in implementing these recommendations.</p> <p>All of the recommendations have either been implemented or are going through ongoing implementation.</p>	No.	Priority	Recommendation	Officer Responsible and Due Date	Status
	6	N/A	<p>Icelandic banks – training</p> <p>All staff involved in undertaking treasury management activities and elected members with responsibility for the stewardship of public money and scrutiny of the treasury management function should undertake ongoing training to ensure they can effectively discharge their responsibilities.</p>	Head of Financial Services February 2010	<p>Ongoing</p> <p>Treasury management training requirements are being reviewed by the Authority generally.</p>
	7	N/A	<p>Icelandic banks - scrutiny</p> <p>The Authority should consider its arrangements for scrutiny of the whole treasury management process and over its individual investment decisions, ensuring that they are informed.</p>	Head of Financial Services February 2010	<p>Implemented</p> <p>Budget and Performance Panel are (and were) responsible for scrutiny of the treasury management process. Reports on treasury management are provided to the Panel on a regular basis on the performance against the strategy.</p>
	8	N/A	<p>Icelandic banks – investment criteria</p> <p>The Authority should strengthen its investment criteria by considering wider economic conditions/factors and other information sources, such as the financial press, in addition to strong credit ratings (with the minimum credit rating being AA) when placing investments. This would minimise the risk of investing in institutions with financial difficulties.</p>	Head of Financial Services February 2010	<p>Implemented</p> <p>The Authority has revised its treasury management strategy, reflecting CIPFA's revised Code for treasury management, following the collapse of the Icelandic banks.</p> <p>The strategy has updated the investment criteria, and whilst not possible to relate solely to AA institutions (due to the feasibility of this) the criteria has been strengthened to be A rated and above. Other factors are also considered before placing funds.</p>

Appendix E: Audit differences

There are no corrected or uncorrected audit differences arising from our work on the financial statements.

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 the Authority's case is the Audit Committee). We are also required to report all material misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities.

Corrected audit differences

No audit differences, other than those which are considered to be clearly trivial, have been identified by our audit of Lancaster City Council's financial statements for the year ended 31 March 2010.

Uncorrected audit differences

There are no uncorrected audit differences to report to the Audit Committee.

Appendix F: Declaration of independence and objectivity

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

Requirements

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

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

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

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

- Details of all relationships between the auditor and the client, its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the client, its directors and senior management and its affiliates, that the auditor considers may reasonably be thought to bear on the auditor’s objectivity and independence.
- The related safeguards that are in place.
- The total amount of fees that the auditor and the auditor’s network firms have charged to the client and its affiliates for the provision of services during the reporting period, analysed into appropriate categories, for example, statutory audit services, further audit services, tax advisory services and other non-audit services. For each category, the amounts of any future services which have been contracted or where a written proposal has been submitted are separately disclosed.

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 Audit Partner and the audit team.

Appendix F: 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.

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.

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 2010, we confirm that there were no relationships between KPMG LLP and the Lancaster City Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

Appendix G: Draft management representation letter

We ask you 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.

The wording for these representations is standard and prescribed by auditing standards.

We require a signed copy of your management representations before we issue our audit opinion.

Dear KPMG LLP,

We understand that auditing standards require you to obtain representations from management on certain matters material to your opinion. Accordingly we confirm to the best of our knowledge and belief, having made appropriate enquiries of other members of the Authority, the following representations given to you in connection with your audit of the financial statements for Lancaster City Council for the year ended 31 March 2010.

All the accounting records have been made available to you for the purpose of your audit and the full effect of all the transactions undertaken by Lancaster City Council has been properly reflected and recorded in the accounting records in accordance with agreements, including side agreements, amendments and oral agreements. All other records and related information, including minutes of all management and Committee meetings, have been made available to you.

We confirm that we have disclosed all material related party transactions relevant to the Authority and that we are not aware of any other such matters required to be disclosed in the financial statements, whether under FRS 8 or other requirements.

We confirm that we are not aware of any actual or potential non-compliance with laws and regulations that would have had a material effect on the ability of the Authority to conduct its business and therefore on the results and financial position to be disclosed in the financial statements for the year ended 31 March 2010.

We acknowledge that we are responsible for the fair presentation of the financial statements in accordance with the Local Government Statement of Recommended Practice ("SORP") and wider UK accounting standards. We have considered and approved the financial statements.

We confirm that we:

- understand that the term "fraud" includes misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Misstatements resulting from fraudulent financial reporting involve intentional misstatements or omissions of amount or disclosures in financial statements to deceive financial statement users. Misstatements resulting from misappropriation of assets involve the theft of an entity's assets, often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorisation;
- are responsible for the design and implementation of internal control to prevent and detect fraud and error;
- have disclosed to you our knowledge of fraud or suspected fraud affecting the Authority involving:
 - management;
 - employees who have significant roles in internal control; or
 - others where the fraud could have a material effect on the financial statements.
- have disclosed to you our knowledge of any allegations of fraud, or suspected fraud, affecting the Authority's financial statements communicated by employees, former employees, analysts, regulators or others; and
- have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

Appendix G: Draft management representation letter (continued)

We confirm that the presentation and disclosure of the fair value measurements of material assets, liabilities and components of equity are in accordance with applicable reporting standards. The amounts disclosed represent our best estimate of fair value of assets and liabilities required to be disclosed by these standards. The measurement methods and significant assumptions used in determining fair value have been applied on a consistent basis, are reasonable and they appropriately reflect our intent and ability to carry out specific courses of action on behalf of the Authority where relevant to the fair value measurements or disclosures.

We confirm that there are no other contingent liabilities, other than those that have been properly recorded and disclosed in the financial statements. In particular:

- there is no significant pending or threatened litigation, other than that already disclosed in the financial statements; and
- there are no material commitments or contractual issues, other than those already disclosed in the financial statements.

Finally, no additional significant post balance sheet events have occurred that would require additional adjustment or disclosure in the financial statements, over and above those events already disclosed.

This letter was tabled at the meeting of the Audit Committee on 22 September 2010.

Yours faithfully

[Name of Executive Director signing letter on behalf of Lancaster City Council]

On behalf of Lancaster City Council