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Report to those charged with governance (ISA 260) 2011/12

Lancaster City Council

September 2012

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 which is available on the Audit Commission's website at www.auditcommission.gov.uk.

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

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Stephen Clark, the appointed engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, 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.

Introduction

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 2012; and**
- **our assessment of the Authority's arrangements to secure value for money (VFM) in its use of resources.**

Financial statements

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

Planning → Control Evaluation → Substantive Procedures → Completion

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.

Our final accounts visit on site took place between 16 and 27 July. During this period, 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 are now in the final phase of the audit. Some aspects are also discharged through this report:

Completion

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

VFM conclusion

We have also now completed our work in respect of the 2011/12 VFM conclusion. This included work to complete an assessment of the significant risks related to VFM for Lancaster City Council.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out the key findings from our audit work in relation to the 2011/12 financial statements.
- Section 4 outlines the 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 year recommendations and this is detailed in Appendix 2.

Acknowledgements

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

Headlines

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

Proposed audit opinion	We anticipate issuing an unqualified audit opinion by 30 September 2012. We will also report that the wording of your Annual Governance Statement accords with our understanding of the Authority's activities.
Audit adjustments	Our audit has not identified any significant audit adjustments; however a number of presentational changes have been made to the notes to the Financial Statements which have been agreed with management and changed in the final version of the Financial Statements. We have raised a number of recommendations that will strengthen the Authority's control environment. These are detailed in Appendix 1.
Critical accounting matters	We have worked with Officers and performed work in relation to the key risks identified during the planning phase of our audit. We are satisfied that the Authority has appropriate arrangements in place to address the risks and issues that we have identified.
Accounts production and audit process	The quality of the accounts and the supporting working papers has been maintained at a high standard in 2011/12, which assists with the delivery of an effective and efficient audit. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales. The Authority has made some progress in implementing the recommendations in our *ISA 260 Report 2010/11* relating to the financial statements however 5 recommendations remain outstanding.
Completion	At the date of this report our audit of the financial statements is substantially complete, there are two areas still to be finalised. ▪ Whole of Government Accounts final review. ▪ A review of any post balance sheet events up to the date of signing our audit report. Before we can issue our opinion we require a signed management representation letter. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.
VFM conclusion	We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2012.
VFM risk areas	We have considered the specific VFM risks we set out in our *Audit Fee Letter 2011/12,* which were in relation to the financial resilience of the Authority and ability to secure VFM. The focus of the criteria for 2011/12 was on whether: - The organisation has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future. -The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

Proposed opinion and audit differences

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

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

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion by 30 September 2012.

Audit differences

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which in 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.

We did not identify any material misstatements as a result of our audit work. There are no adjusted or unadjusted audit differences to report in 2011/12.

We identified a number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting the United Kingdom 2011/12 ('the Code')* which have been amended in the final version of the financial statements.

Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

- it complies with *Delivering Good Governance in Local Government: A Framework* published by CIPFA/SOLACE in June 2007; and
- it is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

Analysis of movements in the General Fund and Balance Sheet

Movements on the General Fund 2011/12	£m
Deficit on the provision of services	(6,803)
Adjustments between accounting basis & funding basis under Regulations	7,165
Transfers to earmarked reserves	(1,362)
Decrease in General Fund	**(1,000)**

Balance Sheet as at 31 March 2012	£m
Property, plant and equipment	209,257
Other long term assets	36,709
Current assets	20,341
Current liabilities	(8,865)
Long term liabilities	(122,248)
Net worth	**135,194**
General Fund	(2,674)
Other reserves	(132,520)
Total reserves	**(135,194)**

Critical accounting matters

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

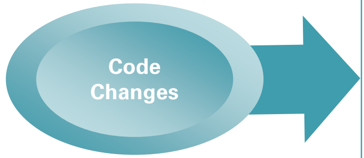
In our *External Audit Plan 2011/12*, presented to you in March, we identified the key risks affecting the Authority's 2011/12 financial statements.

We have now completed our testing of these areas and set out here our final evaluation following our substantive work.

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

Key audit risk	Issue	Findings
	**Savings Plans** The Authority's 2011/12 budget included a range of cost saving targets identified in response to government funding cuts As at December 2011 the Authority was forecasting that it would deliver its 2011/12 budget, with an under spend of £37,000. The Authority has set a balanced budget for 2012/13 but currently estimates that an additional £408,000 of savings will be required for 2013/14 and £440,000 in 2014/15. For many Authorities it is likely to become more and more difficult to deliver these savings in a way that secures longer term financial and operational sustainability.	The final outturn for 2011/12 represented an under-spend of £653,000 against the Revised Budget which was updated in January 2012. During the year the Authority has made significant savings in order to cope with the reductions in Local Government funding introduced as a result of the Comprehensive Spending Review in 2010. In total efficiencies and savings of approximately £450,000 have been achieved in service areas linked to corporate priorities. Our detailed budgetary control testing found the Authority has robust procedures in place to monitor budget variances and implement remedial action as necessary. However additional savings of £182,000, growth of £405,000 and contributions from reserves of £418,000 will be required in 2012/13 to bridge the Authority's budget gap. The Authority estimates these savings will be delivered before the year end with the exception of £29,000 which will be deferred, relating to revised operating hours for CCTV staff. We will continue to monitor the Authority's financial position going forward to ensure that savings targets are being achieved and performance is in line with expectations and budget.

Critical accounting matters (continued)

Key audit risk	Issue	Findings
	**Code Changes** The 2011/12 *Local Government Accounting Code of Practice ("the Code)"* includes a number of accounting changes, including a new requirement to carry 'heritage assets' at valuation. Heritage assets include historical buildings, museum and gallery collections and works of art. The 2011/12 *Code* also clarifies requirements in a number of areas where ambiguity was identified in the 2010/11 *Code.* The Authority needs to review and appropriately address *Code* changes in its 2011/12 financial statements.	The Finance Team at the Authority have a good understanding of the Code requirements and the changes that have been required for 2011/12. We held discussions with key staff throughout the audit process to ensure the impact of the accounting changes relating to heritage assets were reflected in the financial statements. As a result of the changes, £7.9m of assets have been recognised in the balance sheet for the first time. We performed detailed audit testing on the valuation of the heritage assets disclosed in the financial statements. This work did not identify any issues. Other key changes include enhanced disclosure of termination benefits received by former employees. This disclosure is designed to provide the reader of the accounts with additional information and ensure that the accounts are transparent. In addition, as part of our quality checks over the financial statements, we have reviewed all disclosures to ensure that they are in line 2011/12 Code of Practice. As a result of this review, minor presentational changes have been made to the accounts which have been agreed with management.

Critical accounting matters (continued)

Key audit risk	Issue	Findings
	**Future of Lancaster Market** The Authority currently leases the Lancaster Market on a long term lease from Allied (Lancaster) Limited. During the year, Members have taken the decision to review the current lease arrangements with a view to negotiating a surrender of this lease. It is likely that any successful negotiation will result in a significant payment to break the current lease. The Council must ensure that it fully understands the implications of surrendering the lease from both a financial statements and financing perspective. Similarly, the Council must be able to demonstrate that any actions taken represent value for money.	Discussions over the future of the Lancaster Market have been a key area of focus throughout our audit in 2011/12. Although no formal decision was made to terminate the lease agreement during 2011/12, it has been important for us to assess the impact of any potential decisions on the Authority's financial position in the future as this will be a key area of judgement and focus for us in 2012/13. A number of accounting proposals relating to the market have been presented to us by the Authority for consideration. With the help of technical experts from our Department for Professional Practice, we have critically appraised each of the options and provided comments which the Authority may wish to consider. During the year, the Authority has also reviewed the value of the market within the financial statements which has been impaired by £6.015m to reflect its loss making nature. The Authority has however increased the value of the lease liability by £2.5m to reflect the value of the associated land on which the market is situated and which was previously not included. This is in line with revisions made to the Code in 2011/12. To date, the Authority has not made a formal decision in relation to the future of the market. This issue will remain a key audit risk in 2012/13.

Accounts production and audit process

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

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

The Authority has implemented the majority of the prior year recommendations included in our *ISA 260 Report 2010/11.*

Accounts production and audit process

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

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority has a strong financial reporting process. We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 06 July 2012 which was in line with our expectations. The accounts were signed by the Head of Financial Services before the 30 June deadline.
Quality of supporting working papers	Our *'Prepared by Client List'* set out our working paper requirements for the audit. The quality of working papers provided was high and met our requirements.
Response to audit queries	Officers resolved the majority of audit queries in a reasonable time.

Prior year recommendations

The Authority has now implemented the majority of the recommendations in our *ISA 260 Report 2010/11* relating to the financial statements.

Appendix 2 provides further details.

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 2012, 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 3 in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Financial Services Manager, a draft of which is reproduced in Appendix 4. 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 etc.).

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority's 2011/12 financial statements.

VFM conclusion

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

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

Background

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

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

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

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

Conclusion

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

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

The following page includes further details on our specific risk-based work.

Specific VFM risks

We have considered the specific VFM risks we set out in our Audit Fee letter 2011/12.

In our *Audit Fee letter 2011/12* we set out our VFM audit approach.

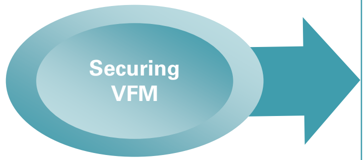
This identified financial resilience as a key risk for the Authority. As a result, our work to support our value for money opinion has focussed on the Authority's financial planning and management over the medium to long-term period.

Further details of our findings are contained below.

Key VFM risk	Focus of our work	Key findings
	The systems and processes used by the Authority to manage effectively financial risks and opportunities, and the ability of the Authority to secure a stable financial position that enables it to continue to operate for the foreseeable future.	Throughout the year we have reviewed the Authority's budget and financial plans to ensure they accurately reflect the Authority's financial position. The Authority has robust budgetary control procedures in place and key variances are reviewed by senior management. The Authority has had to make significant savings during the year as a result of Local Government funding cuts arising from the Comprehensive Spending Review. The Authority has achieved its target of £465,000 of efficiencies and savings during 2011/12 however additional savings of £182,000 will be required in 2012/13. The Authority achieved a £653,000 under-spend against its Revised Budget for the year ended 31 March 2012 demonstrating it is able to secure a stable financial position that enables it to continue to operate for the foreseeable future.

Specific VFM risks (continued)

We have considered the specific VFM risks we set out in our Audit Fee letter 2011/12.

Key VFM risk	Focus of our work	Key findings
	The prioritisation of resources within tighter budgets, for example the achievement of cost reductions and improvements in efficiency and productivity.	The arrangements in place for identifying, implementing and monitoring cost improvement programmes were sufficient to ensure the Authority achieved its financial budget in 2011/12. During our audit we have discussed with management options relating to the future of the Lancaster Market. The Authority has provided evidence to demonstrate that they are formally assessing the implications of all options from both a financial and VFM perspective. To date a formal decision has not been made regarding the future of the market however, we will continue to monitor progress and decisions made going forward. We have gained assurance throughout the audit process that the Authority has implemented appropriate measures to secure economy, efficiency and effectiveness in the Authority's use of resources.

Appendix 1: Key issues and recommendations

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

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

We will formally follow up these recommendations next year.

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

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
1	❸	**Bank reconciliation** Whilst no material misstatements were identified in the year-end bank reconciliation, there are a number of historic immaterial errors which are rolled forward each year. As a result the bank reconciliation is becoming increasingly complex and difficult to follow leading to a risk that un-reconciled amounts may become significant unidentifiable. We recommend that all historical reconciling items are investigated and cleared so they no longer appear on the bank reconciliation.	**Management response:** Agreed **Officer responsible:** Financial Services Manager **Due date:** 31 March 2013
2	❸	**Payroll Controls** The payroll to GL reconciliation is not signed as prepared or reviewed. Consequently there is an insufficient audit trail to demonstrate that the control has been operating effectively and on timely basis throughout the year. The Authority should ensure that all reconciliations are signed and dated as prepared and reviewed in order to provide a sufficient audit trail that the control has been operating as designed.	**Management response:** This will be addressed through system replacements **Officer responsible:** Financial Services Manager **Due date:** 31 March 2013

Appendix 2: Follow up of prior year recommendations

The Authority has not implemented all of the recommendations in our *ISA 260 Report 2010/11.*

Although the outstanding recommendations are not of high risk, we re-iterate the importance of the recommendations and recommend that these are implemented as a matter of urgency.

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2010/11* and re-iterates any recommendations still outstanding.

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

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2012
1	3	**General Ledger/Debtors and creditors reconciliations** The Authority's reconciliation between the general ledger and the creditors and debtors systems is not signed as prepared or reviewed. This means that there is a limited audit trail over the timeliness of preparation and review of the control The Authority should ensure that the reconciliation and review process is fully documented to provide a sufficient audit trail.	**Systems Support Accountant September 2011**	Our testing of the debtors and creditors reconciliations in 2011/12 identified a number of instances where reconciliations have been signed as prepared but where there is no evidence of review. We recommend all reconciliations are signed as prepared and as reviewed to provide a full audit trail. **Status:** Partially implemented.

Appendix 2: Follow up of prior year recommendations (continued)

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2012
2	3	**General Ledger/Council Tax and NNDR reconciliation** The Authority's interface between the general ledger and Council Tax and NNDR system does not always work effectively. As a result, management have developed a reconciliation to identify the differences to ensure that the two systems reflect the appropriate information. The reconciliation involves a large amount of manual input and is very complicated in its nature. This presents a risk to the accuracy of the data within the general ledger system. In addition, the frequency of the performance of the reconciliation has reduced during the year, which increases the risk of errors going undetected. Management should review the current process of reconciling the two systems and try to: ■ reduce the complex nature of the reconciliation; ■ increase the accuracy of the automatic interface, so as to reduce the level of manual intervention; and ■ increase the frequency of the reconciliation to at least a monthly basis.	**Accountancy Services Manager** **March 2012**	Our audit work during 2011/12 has found that there continues to be on going problems between the systems interface. However, our review of the reconciliation between the Council Tax and NNDR system found that although discrepancies between the interfaces continue to occur, the authority is able to produce clear working papers to demonstrate how the two systems reconcile. **Status:** Implemented.

Appendix 2: Follow up of prior year recommendations (continued)

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2012
3	3	**System access rights to financial systems** There is no periodic review of system access rights for financial systems. As a result there is a risk that employees have inappropriate access to the financial systems. Management should review the access rights to its financial systems on a periodic basis to ensure that access rights remain appropriate.	**Systems Support Accountant** **November 2011**	Through discussions with IT staff at the Authority we have identified that a review of access rights has been performed during the year. However, the outcome of the review was not formally documented, leading to a lack of evidence to demonstrate that the review took place and that the recommendation was implemented. The Authority should ensure that any future review of access rights is formally documented in order to demonstrate the review has been performed during the year. **Status:** Partially implemented.
4	3	**Testing of the disaster recovery system** Best practice would be for the Authority to test the backups of its financial systems on an annual basis to ensure that its disaster recovery plan is working effectively. As part of our IT systems work there was no evidence to support that backups of the system had been tested to ensure they recovered data effectively.	**Information Services Manager** **January 2012**	Our testing of General IT Controls found no issues with regards to data recovery procedures in 2011/12. **Status:** Implemented.

Appendix 2: Follow up of prior year recommendations (continued)

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2012
5	3	**Posting and authorising of journals.** From our controls testing of journals we discovered that Principal Accountants at the Authority are able to post and authorise their own journals. There should be segregation of duties between those that can post journals and those that can authorise them to ensure that journals are not incorrectly/inappropriately posted.	**Accountancy Services Manager** **N/A**	Our testing of journals during 2011/12 found that Principal Accountants at the Authority continue to be able to post and authorise their own journals. Due to the large number of journals posted by Principal Accountants at the Authority, it is not deemed feasible for each one to be separately authorised. We therefore recommend that the Accountancy Services Manager should perform a scan review of the monthly journal listing to ensure that journals being posted are in line with expectations. The journals list should be signed and dated to provide evidence that this review has taken place. **Status:** Recommendation superseded
6	3	**Review of open orders** We were unable to confirm that a review of open orders had been completed by each service area as part of the accounts closedown process. The Authority should retain evidence of this review to ensure it has correctly considered what liabilities require disclosing at year end.	**Accountancy Services Manager** **March 2012**	In 2011/12 we performed audit work to verify whether the Authority had identified all outstanding liabilities at year end. No unrecorded liabilities or issues with the month end procedures were identified. **Status:** Implemented

Appendix 2: Follow up of prior year recommendations (continued)

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2012
7	3	**Physical verification of property, plant and equipment** The Authority does not perform a formal annual physical verification of its plant and equipment to confirm existence of those assets. Property is typically verified through the asset valuation process. Management should introduce a process to ensure that its fixed asset records remain accurate.	**Internal Audit Manager** **March 2012**	In response to this recommendation the Authority stated that Internal Audit would undertake a corporate review of arrangements for compiling and maintaining inventories during 2011/12. We have reviewed the findings recorded by Internal Audit from their in year review. Limited assurance was given and an action plan has been devised for the Authority which must now be implemented. **Status:** Partially Implemented.
8	3	**Payroll controls** There were a number of payroll control weaknesses we detected as part of our audit work. These included: ■ No independent review of payroll exception reports; and ■ The payroll system and personnel systems do not reconcile. These weaknesses increase the likelihood of the payroll costs in the accounts being misstated.	**Payroll - Exchequer Services Manager September 2011** **Payroll / HR System Human Resources Manager / Accountancy Services Manager / April 2012.**	Our audit work has confirmed that payroll exception reports have been prepared and reviewed by the Authority during 2011/12. Discrepancies do continue to occur between the payroll system and personnel system. However this issue will be resolved with the implementation of the new payroll system in 2012/13. **Status:** Partially Implemented.

Appendix 3: 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. 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 Audit Partner and the audit team.

General procedures to safeguard independence and objectivity

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

Appendix 3: Declaration of independence and objectivity (continued)

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

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

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

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

Auditor declaration

In relation to the audit of the financial statements of Lancaster City Council for the financial year ending 31 March 2012, 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.

Appendix 4: Draft management representation letter

We ask you to provide us with representations on specific matters such as whether the transactions within the accounts are legal and unaffected by fraud.

The wording for these representations is prescribed by auditing standards.

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

Dear Sirs

This representation letter is provided in connection with your audit of the financial statements of Lancaster City Council ("the Authority") for the year ended 31 March 2012, for the purpose of expressing an opinion:

i. as to whether these financial statements give a true and fair view of the financial position of the Authority as at 31 March 2012 and of the Authority's expenditure and income for the year then ended; and

ii. whether the financial statements have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

These financial statements comprise the Authority Movement in Reserves Statement, the Authority Comprehensive Income and Expenditure Statement, the Authority Balance Sheet, the Authority Cash Flow Statement, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement and the Collection Fund and the related notes.

The Authority confirms that the representations it makes in this letter are in accordance with the definitions set out in the Appendix to this letter.

The Authority confirms that, to the best of its knowledge and belief, having made such inquiries as it considered necessary for the purpose of appropriately informing itself:

Financial statements

1. The Authority has fulfilled its responsibilities, as set out in regulation 8 of the Accounts and Audit (England) Regulations 2011, for the preparation of financial statements that:
   - give a true and fair view of the financial position of the Authority as at 31 March 2012 and of the Authority's income and expenditure for the year then ended
   - have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

   The financial statements have been prepared on a going concern basis.

2. Measurement methods and significant assumptions used by the Authority in making accounting estimates, including those measured at fair value, are reasonable.

3. All events subsequent to the date of the financial statements and for which the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom require adjustment or disclosure have been adjusted or disclosed.

Information provided

4. The Authority has provided you with:
   - access to all information of which it is aware, that is relevant to the preparation of the financial statements, such as records, documentation and other matters;
   - additional information that you have requested from the Authority for the purpose of the audit; and
   - unrestricted access to persons within the Authority from whom you determined it necessary to obtain audit evidence.

5. All transactions have been recorded in the accounting records and are reflected in the financial statements.

6. The Authority acknowledges its responsibility for such internal control as it determines necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In particular, the Authority acknowledges its responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

   The Authority has disclosed to you the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

Appendix 4: Draft management representation letter

We ask you to provide us with representations on specific matters such as whether the transactions within the accounts are legal and unaffected by fraud.

The wording for these representations is prescribed by auditing standards.

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

7. The Authority has disclosed to you all information in relation to:

a) Fraud or suspected fraud that it is aware of and that affects the Authority and involves:

- management;
- employees who have significant roles in internal control; or
- others where the fraud could have a material effect on the financial statements; and

b) allegations of fraud, or suspected fraud, affecting the Authority financial statements communicated by employees, former employees, analysts, regulators or others.

8. The Authority has disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements.

9. The Authority has disclosed to you and has appropriately accounted for and/or disclosed in the financial statements in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.

10. The Authority has disclosed to you the identity of the Authority's related parties and all the related party relationships and transactions of which it is aware and all related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

    Included in the Appendix to this letter are the definitions of both a related party and a related party transaction as the Authority understands them and as defined in IAS 24, except where interpretations or adaptations to fit the public sector are detailed in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

11. On the basis of the process established by the Authority and having made appropriate enquiries, the Authority is satisfied that the actuarial assumptions underlying the valuation of pension scheme liabilities are consistent with its knowledge of the business.

The Authority further confirms that:

a) all significant retirement benefits, including any arrangements that:

- are statutory, contractual or implicit in the employer's actions;
- arise in the UK and the Republic of Ireland or overseas;
- are funded or unfunded; and
- are approved or unapproved,

have been identified and properly accounted for; and

b) all settlements and curtailments have been identified and properly accounted for.

This letter was tabled and agreed at the meeting of the Audit Committee on 19 September 2012.

Yours faithfully,

[Chair of the Audit Committee] , [Chief Financial Officer] cutting through complexity ™