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Report to those charged with governance (ISA 260) 2012/13

Lancaster City Council

September 2013

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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, 3rd Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 03034448330.

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 2013; and
- our assessment of the Authority's arrangements to secure value for money (VFM) in its use of resources.

Financial statements

Our *External Audit Plan 2012/13* presented to you in June 2013, set out the four stages of our financial statements audit process.



This report focuses on the second and third stages of the process: control evaluation and substantive procedures. Our on site work for these took place in two tranches during April 2013 (interim audit) and July 2013 (year end audit). We carried out the following work:

Control Evaluation	<ul style="list-style-type: none"> ■ Evaluate and test selected controls over key financial systems ■ Review accounts production process ■ Review progress on critical accounting matters
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Substantive Procedures	<ul style="list-style-type: none"> ■ Planning and performing substantive audit procedures. ■ Concluding on critical accounting matters. ■ Identifying audit adjustments. ■ Reviewing the Annual Governance Statement.
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We are now in the final phase of the audit. Some aspects are also discharged through this report:

Completion	<ul style="list-style-type: none"> ■ Declaring our independence and objectivity. ■ Obtaining management representations. ■ Reporting matters of governance interest. ■ Forming our audit opinion.
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VFM conclusion

Our *External Audit Plan 2012/13* explained our risk-based approach to VFM work, which follows guidance provided by the Audit Commission. We have completed our work to support our 2012/13 VFM conclusion. This included:

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

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out the key findings from our audit work in relation to the 2012/13 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.

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 2013. We will also report that the wording of your Annual Governance Statement accords with our understanding.
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.
Critical accounting matters	<p>We have worked with Officers and performed work in relation to the key risks identified during the planning phase of our audit.</p> <p>We are satisfied that the Authority has appropriate arrangements in place to address the risks and issues that we have identified.</p>
Accounts production and audit process	<p>The quality of the accounts and the supporting working papers has been maintained at a high standard in 2012/13, which assists with the delivery of an effective and efficient audit. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales.</p> <p>The Authority has implemented all of the recommendations in our <i>ISA 260 Report 2011/12</i> relating to the financial statements.</p> <p>However, there are still outstanding recommendations from our <i>ISA 260 Report 2010/11</i>, see Appendix 3 for further details.</p>
Control environment	<p>The Authority's organisation and IT control environment is effective overall, and controls over the key financial systems are sound.</p> <p>We are satisfied that internal audit are compliant with the Code of Practice for Internal Audit in Local Government and have again been able to place reliance on their work where this was relevant to our work.</p> <p>We have raised one recommendation that will strengthen the Authority's control environment. This is detailed in Appendix 1.</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"> ■ Whole of Government Accounts review ■ A review of any post balance sheet events up to the date of signing our audit report. <p>Before we can issue our opinion we require a signed management representation letter.</p> <p>We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.</p>

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

VFM conclusion and risk areas

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 2013.

We have considered the specific VFM risks we set out in our External Audit Plan 2012/13, which were in relation to the financial resilience of the Authority and ability to secure VFM. The focus of the criteria for 2012/13 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.

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 2013.

Audit differences

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

We did not identify any material misstatements as a result of our audit work. There are no adjusted or unadjusted audit differences to report in 2012/13.

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 2012/13 ('the Code')*. These have been agreed with management and changed in the final version of the Financial Statements.

Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

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


Analysis of movements in the General Fund and Balance Sheet

Movements on the General Fund 2012/13	
£m	£m
Deficit on the provision of services	(3,445)
Adjustments between accounting basis & funding basis under Regulations	3,323
Transfers from earmarked Reserves	630
Increase in General Fund	508

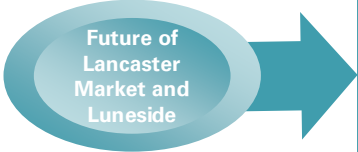
Balance Sheet as at 31 March 2013	
£m	£m
Property, plant and equipment	208,512
Other long term assets	35,349
Current assets	24,690
Current liabilities	(12,912)
Long term liabilities	(130,706)
Net worth	124,933
General Fund	(3,182)
Other usable reserves	(18,233)
Unusable reserves	(103,518)
Total reserves	(124,933)

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

In our *External Audit Plan 2012/13*, presented to you in June, we identified the key risks affecting the Authority's 2012/13 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work. The table below sets out our detailed findings for each risk.

Key audit risk	Issue	Findings
	<p>The Authority estimates it will have surplus resources of £367,000 in 2013/14 (assuming a 2% Council Tax increase), but will need to find savings of £1.1m in 2014/15 and £2.3m in 2015/16 which will need to be addressed during 2013/14. The Authority will need to establish and manage its savings plans to secure longer term financial and operational sustainability and ensure that any related liabilities are accounted for in its 2012/13 financial statements as appropriate.</p>	<p>The final outturn for 2012/13 represented an under-spend of £547,000 against the budget, which was revised in December 2012.</p> <p>During the year, the Authority has made significant savings in order to manage the reductions in Local Government funding introduced as a result of the Comprehensive Spending Review. In total, efficiencies and savings of approximately £991,000 have been achieved across all service areas.</p> <p>Our detailed budgetary control testing found the Authority has robust procedures in place to monitor budget variances and implement remedial action as necessary. However savings of £408,000 will be required in 2013/14 to bridge the Authority's budget gap. The Authority forecasts that these savings will be delivered before the year end.</p> <p>The Council has established and implemented a savings plan to achieve the required savings over the next 3 years. The updated £408,000 savings target has been factored into the 2013/14 budget. Savings will be achieved in all service areas but mainly in Environmental Services where combined employee and vehicle savings are anticipated to total £418,000.</p> <p>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.</p> <p>In addition, our review of the completeness of liabilities has not identified any issues. All liabilities have been appropriately accounted for within the Financial Statements.</p>

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

Key audit risk	Issue	Findings
	<p>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 surrender the lease.</p> <p>Terms of the surrender are being sought through additional negotiations but it is likely that the surrender will result in a significant payment to break the lease. It is currently anticipated that the surrender of the lease will conclude after the year end but before the accounts for 2012/13 are finalised.</p> <p>In addition, the Council is awaiting the outcome of a land tribunal relating to compulsory purchase order compensation at Luneside East.</p> <p>Once the case has been finalised, the Council may be required to update the 2012/13 accounts to reflect the outcomes of the decision.</p>	<p>The Lancaster Market Lease was surrendered in May 2013, after the Balance Sheet date.</p> <p>The Council has not accounted for the transaction in the 2012/13 Financial Statements as it was undertaken after the reporting period and does not meet the criteria of an adjusting event after the reporting period. Instead, the transaction has been disclosed as a non-adjusting event after the reporting period. This is because no binding agreement was in place at the 31 March 2013 as Allied had the right to withdraw.</p> <p>We are satisfied that the transaction has been correctly accounted for within the financial statements and in line with <i>International Accounting Standard (IAS) 10</i>.</p> <p>The Council has opted not to disclose the amount paid to cancel the lease as this is considered commercially sensitive. If this position changes before the date of signing the accounts, additional disclosure may be required.</p> <p>With regards to Luneside East, following determination of the CPO compensation claim by the Lands Tribunal, the Council was granted leave to appeal four heads of the claim. The Court of Appeal found in favour of the Council on three of these heads. The relevance of this decision is that the Lands Tribunal must now re -determine the compensation award and the liability for costs. Management believes that the Appeal decision places the Council in a much stronger position to not only resist the claimants application for costs but also recover some or all of its own costs. The revised costs award should be known within the next month or so.</p> <p>The Council continues to include a contingent asset and liability within the Financial Statements. In the event that a formal Lands Tribunal confirmation is received before the date of accounts signing, the disclosure in the accounts will need to be updated to reflect the updated position.</p>

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

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

The Authority has implemented all of the recommendations in our *ISA 260 Report 2011/12* relating to the financial statements.

Accounts production and audit process

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

We considered the following criteria:

Element	Commentary
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 05 July 2013, which was in line with our expectation. The accounts were signed by the Head of Resources before the 30 June deadline.
Quality of supporting working papers	Our <i>Prepared by Client List</i> set out our working paper requirements for the audit. The quality of working papers provided was high and met our requirements.
Response to audit queries	Officers resolved the majority of audit queries in a reasonable time.

Prior year recommendations

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

The Authority has implemented all of the recommendations in our *ISA 260 Report 2011/12* relating to the financial statements. Appendix 2 provides further details.

However, there are still outstanding recommendations from our *ISA 260 Report 2010/11*, Appendix 3 provides further details.

Your organisational and IT control environment is effective overall.

We noted one area for further improvement relating to super user access rights.

Work completed

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would have implications for our audit.

We obtain an understanding of the Authority’s overall control environment and determine if appropriate controls have been implemented. We do not complete detailed testing of these controls.

The Authority relies on information technology (IT) to support both financial reporting and internal control processes. In order to satisfy ourselves that we can rely on the use of IT, we test controls over access to systems and data, system changes, system development and computer operations.

This work was undertaken by a specialist IT Trained Auditor. A key area of focus was the controls around the payroll system, as the Council upgraded its payroll system during the year.

Key findings

We consider that your organisational and IT controls are effective overall, but identified one issue during our audit:

- As part of our General IT Controls testing, we identified 4 users who had super user access but no longer required this level of access. Their access was originally granted to allow them to assist with a program change, however it had not been subsequently been revoked.

The Council has now revoked this access.

Aspect	Assessment
<i>Organisational controls:</i>	
Management’s philosophy and operating style	3
Culture of honesty and ethical behaviour	3
Oversight by those charged with governance	3
Risk assessment process	3
Communications	3
Monitoring of controls	3
<i>IT controls:</i>	
Access to systems and data	2
System changes and maintenance	3
Development of new systems and applications	3
Computer operations and end-user computing	3

- Key:
- 1 Significant gaps in the control environment.
 - 2 Deficiencies in respect of individual controls.
 - 3 Generally sound control environment.

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 2013, 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 4 in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Financial Services Manager, a draft of which is reproduced in Appendix 5. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

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

- significant difficulties encountered during the audit;
- significant matters arising from the audit that were discussed, or

subject to correspondence with management;

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

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority's 2012/13 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 pages include further details of our specific risk-based work.


We have considered the specific VFM risks we set out in our External Audit Plan 2012/13.

Key findings


In our External Audit Plan 2012/13 we set out our VFM audit approach.

This identified financial resilience and Securing VFM as key risks 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
	<p>The systems and processes used by the Authority to manage effectively financial risks and opportunities, and the ability of the Authority to secure a stable financial position that enables it to continue to operate for the foreseeable future.</p>	<p>Throughout the year we have reviewed the Authority’s budget and financial plans to ensure they accurately reflect the Authority’s financial position. The Authority has robust budgetary control procedures in place and key variances are reviewed by senior management and reported to the Budget and Performance Panel.</p> <p>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 £991,000 of efficiencies and savings during 2012/13 however additional savings of £408,000 will be required in 2013/14 and £440,000 and 2014/15. It is known, however, that these savings targets will increase as a result of the Government’s recent spending review.</p> <p>The Authority has developed and Implemented Savings Plans which cover a rolling three year period. For example, after quarter 1 management review the savings identified for the current year and services are also required to identify new savings for future years, which are fed into the Medium Term Financial Strategy review in September.</p> <p>The Authority achieved a £547,000 under-spend against its Revised Budget for the year ended 31 March 2013 demonstrating it is able to secure a stable financial position that enables it to continue to operate for the foreseeable future.</p>

We have considered the specific VFM risks we set out in our External Audit Plan 2012/13.

Key VFM risk	Focus of our work	Key findings
	<p>The prioritisation of resources within tighter budgets, for example the achievement of cost reductions and improvements in efficiency and productivity.</p>	<p>The arrangements in place for identifying, implementing and monitoring savings and efficiency reviews were sufficient to ensure the Authority achieved its financial budget in 2012/13.</p> <p>During our audit we have discussed with management the progress of the surrender of the Lancaster Market lease. Although Council gave Officers permission to discuss the terms of the lease surrender in November 2011, the surrender of the lease did not take place until May 2013. This was in large due to the Authority formally assessing the implications of all options from both a financial and VFM perspective.</p> <p>We have gained assurance throughout the audit process that the Authority has implemented appropriate measures to secure economy, efficiency and effectiveness in the Authority's use of resources.</p>

We have given our 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 recommendation.

We will formally follow up this recommendation next year.

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

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

Appendix 2: Follow up of prior year recommendations

The Authority has implemented all of the recommendations in our ISA 260 Report 2011/12.

This appendix summarises the progress made to implement the recommendations identified in our ISA 260 Report 2011/12 and re-iterates any recommendations still outstanding.

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

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2013
1	3	<p>Bank reconciliation</p> <p>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.</p> <p>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.</p> <p>We recommend that all historical reconciling items are investigated and cleared so they no longer appear on the bank reconciliation.</p>	<p>Management response: Agreed</p> <p>Officer responsible: Financial Services Manager</p> <p>Due date: 31 March 2013</p>	<p>Our testing of bank reconciliations has identified that historical reconciling items have been investigated and cleared from the bank reconciliation.</p> <p>Status: Implemented</p>

Appendix 2: Follow up of prior year recommendations (cont.)

The Authority has implemented all of the recommendations in our ISA 260 Report 2011/12.

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2013
2	3	<p>Payroll Controls</p> <p>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.</p>	<p>Management response: This will be addressed through system replacements</p> <p>Officer responsible: Financial Services Manager</p> <p>Due date: 31 March 2013</p>	<p>We reviewed a sample of payroll to GL reconciliations and found that they had been appropriately signed as prepared and reviewed.</p> <p>Status: Implemented</p>

Appendix 3: Follow up of 2010/11 outstanding recommendations

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

We re-iterate the importance of the outstanding 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 found to be still outstanding in our ISA 260 2011/12.

Number of recommendations that were:	
Outstanding in ISA260 2011/12 report	5
Implemented in year or superseded	2
Remain outstanding (re-iterated below)	3

No.	Risk	Issue, recommendation, Officer responsible and due date	Status as at September 2012	Status as at September 2013
1	3	<p>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</p> <p>The Authority should ensure that the reconciliation and review process is fully documented to provide a sufficient audit trail.</p> <p>Officer responsible: Systems Support Accountant</p> <p>Due date: September 2011</p>	<p>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.</p> <p>We recommend all reconciliations are signed as prepared and as reviewed to provide a full audit trail.</p> <p>Status: Partially implemented.</p>	<p>We reviewed a sample of payroll to GL to Debtors/Creditors ledger reconciliations and found that they had been appropriately signed as prepared and reviewed.</p> <p>Status: Implemented</p>

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

No.	Risk	Issue, recommendation, Officer responsible and due date	Status as at September 2012	Status as at September 2013
2	3	<p>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.</p> <p>Management should review the access rights to its financial systems on a periodic basis to ensure that access rights remain appropriate.</p> <p>Officer responsible: Systems Support Accountant Due date: November 2011</p>	<p>Through discussions with IT staff at the Authority we have identified that a review of access rights has been performed during the year.</p> <p>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.</p> <p>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.</p> <p>Status: Partially implemented.</p>	<p>We have ascertained that no further reviews of access rights have been undertaken during the year.</p> <p>Status: Partially Implemented.</p>

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

No.	Risk	Issue, recommendation, Officer responsible and due date	Status as at September 2012	Status as at September 2013
3	3	<p>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.</p> <p>There should be segregation of duties between those that can post journals and those that can authorise them to ensure that journals are not incorrectly/inappropriately posted.</p> <p>Officer responsible: Accountancy Services Manager Due date: N/A</p>	<p>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.</p> <p>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.</p> <p>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.</p> <p>Status: Recommendation superseded</p>	<p>As issues relating to segregation of duties were once again identified as part of our 13/14 journals controls testing, we followed up the implementation of the recommended compensating control. However, testing confirmed that no formal sign off of monthly journal summaries is undertaken.</p> <p>Status: Outstanding</p>

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

No.	Risk	Issue, recommendation, Officer responsible and due date	Status as at September 2012	Status as at September 2013
4	3	<p>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.</p> <p>Management should introduce a process to ensure that its fixed asset records remain accurate.</p> <p>Officer responsible: Internal Audit Manager Due date: March 2012</p>	<p>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.</p> <p>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.</p> <p>Status: Partially Implemented.</p>	<p>The Council's Financial Services Manager is currently producing a standardised asset inventory template which will be rolled out across all services. This will be accompanied by written guidelines for each service area to adhere to and will ensure that the Council's asset inventories are up to date.</p> <p>Status: Partially Implemented.</p>

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

No.	Risk	Issue, recommendation, Officer responsible and due date	Status as at September 2012	Status as at September 2013
5	3	<p>Payroll controls There were a number of payroll control weaknesses we detected as part of our audit work. These included:</p> <p>No independent review of payroll exception reports; and The payroll system and personnel systems do not reconcile.</p> <p>These weaknesses increase the likelihood of the payroll costs in the accounts being misstated.</p> <p>Officers responsible and due date:</p> <p>Payroll - Exchequer Services Manager September 2011</p> <p>Payroll / HR System Human Resources Manager / Accountancy Services Manager April 2012.</p>	<p>Our audit work has confirmed that payroll exception reports have been prepared and reviewed by the Authority during 2011/12.</p> <p>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.</p> <p>Status: Partially Implemented.</p>	<p>Through our review of the implementation of the new system upgrade, we are satisfied that the issue of discrepancies between the payroll and personnel system are no longer prevalent. The new system has resolved this issue.</p> <p>Status: Recommendation Superseded</p>

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.

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 2013, 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 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 2013, 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 2013 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 2012/13.

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 2013 and of the Authority's expenditure and income for the year then ended; and
 - have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

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 2012/13 requires 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.

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 financial statements communicated by employees, former employees, analysts, regulators or others.

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.

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 2012/13 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 2012/13.

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 2012/13.

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.

12. The surrender of the Lancaster Market lease has been appropriately accounted for as a non-adjusting post balance sheet event.

This letter was tabled and noted at the meeting of the Audit Committee on 18 September 2013.

Yours faithfully,

Head of Resources and Section 151 Officer

On behalf of Lancaster City Council *Use the actual title*



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