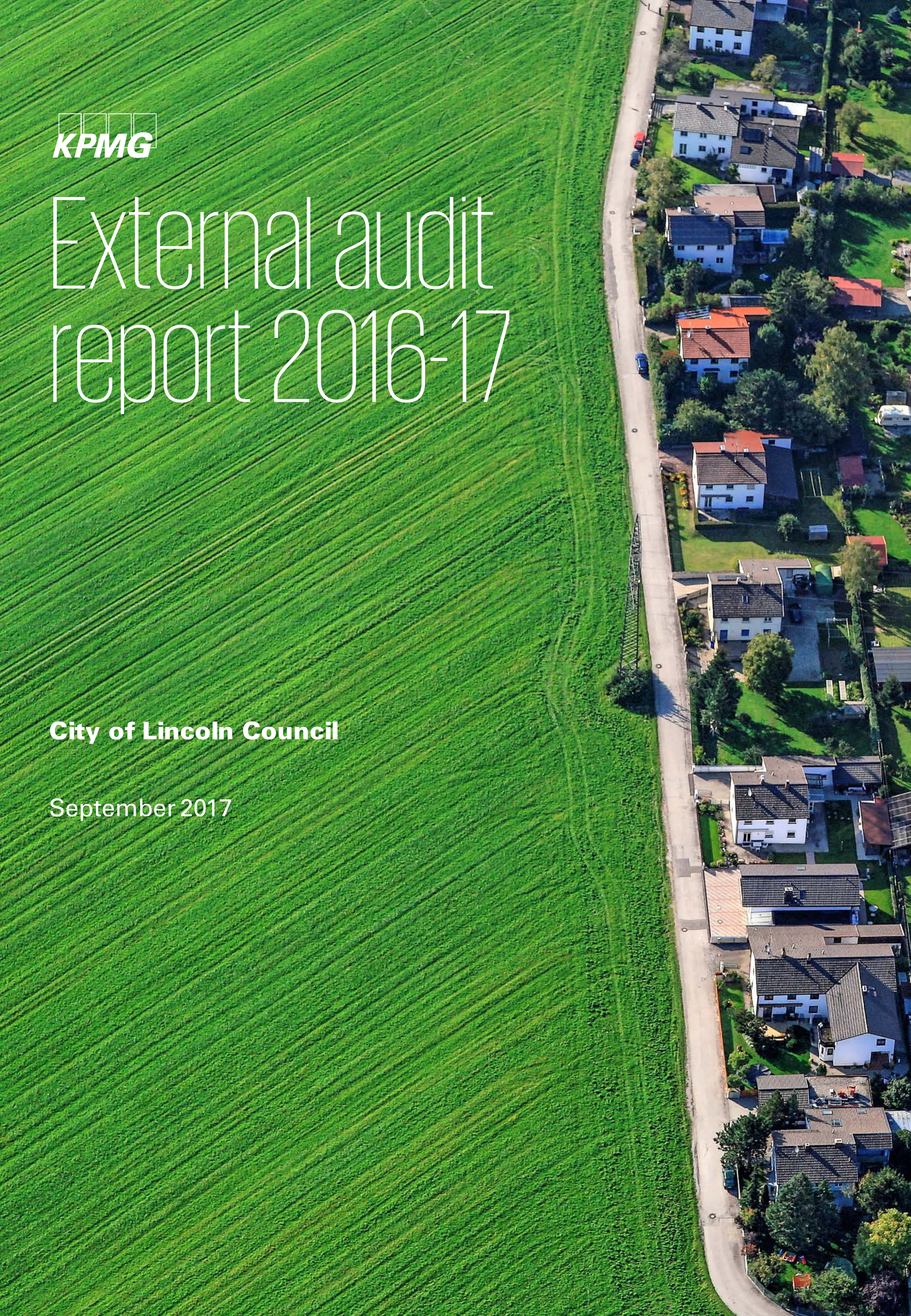

KPMG

External audit report 2016-17

City of Lincoln Council

September 2017

Summary for Audit Committee

Financial statements

This document summarises the key findings in relation to our 2016-17 external audit at City of Lincoln Council ('the Authority').

This report focusses on our on-site work which was completed in July and August 2017 on the Authority's significant risk areas, as well as other areas of your financial statements. Our findings are summarised in Section 1.

Subject to all outstanding queries being resolved to our satisfaction we anticipate issuing an unqualified audit opinion on the Authority's financial statements before the deadline of 30 September 2017.

There are currently the following outstanding matters:

- Final audit Director review;
- Addressing any remaining audit queries and any matters arising from our completion procedures;
- General audit file completion and review procedures;
- Post balance sheet events review up to the date of signing the audit opinion; and
- Final review of the working papers and amended accounts.

Our audit identified significant audit differences, including one material audit adjustment. The net impact of the adjustments is a reduction in the Authority's balance sheet net worth of £4.5m, although the General Fund, HRA and other useable balances are unchanged. There were also non-material errors and a number of presentational matters which officers agreed to amend in the final statement of accounts. See Appendix 2 for details.

Based on our work, we have raised 2 recommendations. Details on our recommendations can be found in Appendix 1.

Subject to clearance of our final queries and final (including Director) review we are moving into the completion stage of the audit and currently anticipate issuing our completion certificate alongside the opinion and vfm conclusion in September 2017.

Use of resources

We have completed our risk-based work to consider whether in all significant respects the Authority has proper arrangements to ensure it has taken properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. 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 value for money opinion.

See further details in section two.

Public Interest Report

We have a duty to consider whether to issue a report in the public interest about something we believe the Authority should consider, or if the public should know about. We have nothing to report.

Acknowledgements

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

We ask the Audit Committee and Council to note this report.

The key contacts in relation to our audit are:

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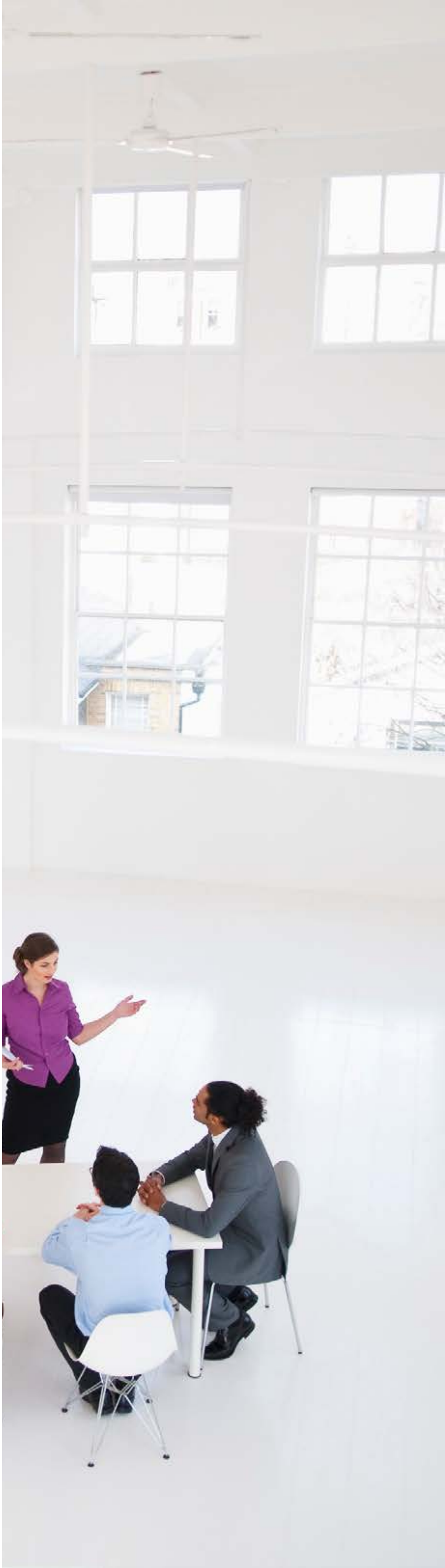
Contents

Section one

Financial Statements

We anticipate issuing an unqualified audit opinion on the Authority's 2016-17 financial statements by 30 September 2017. We will also report that your Annual Governance Statement complies with the guidance issued by CIPFA/SOLACE (*'Delivering Good Governance in Local Government'*) published in April 2016.



Significant audit risks

Our *External Audit Plan 2016-17* sets out our assessment of the Authority's significant audit risks. We have completed our testing in these areas and set out our evaluation following our work:

Significant audit risks	Work performed
1. Significant changes in the pension liability due to LGPS Triennial Valuation	**Why is this a risk?** During the year, the Pension Fund has undergone a triennial valuation with an effective date of 31 March 2016 in line with the *Local Government Pension Scheme (Administration) Regulations 2013*. The share of pensions assets and liabilities for each admitted body is determined in detail, and a large volume of data is provided to the actuary to support this triennial valuation. There is a risk that the data provided to the actuary for the valuation exercise is inaccurate and that these inaccuracies affect the actuarial figures in the accounts. Most of the data is provided to the actuary by Lincolnshire County Council, who administer the Pension Fund. **Our work to address this risk** We have reviewed the process used to submit payroll data to the Pension Fund and have found no issues to note. We have also tested the year-end submission process and other year-end controls. We have also substantively agreed the total figures submitted to the actuary to the ledger with no issues to note. We have engaged with the Lincolnshire Pension Fund auditors to gain assurance over the pension figures. We also engaged specialists from our KPMG pensions team to assess the actuary's approach and the reasonableness of the assumptions used in determining the pensions estimates. There are no significant matters from our work which we need to draw to your attention.
2. Accounting for the Transport Hub project	**Why is this a risk?** The Department of Transport approved the £30m Transport Hub project in August 2016 and the work is in progress. The scheme is expected to be complete by early 2018. The Authority needs to have effective accounting arrangements in place for this project. **Our work to address this risk** We have undertake specific PPE testing over this addition to confirm that costs have been capitalised appropriately and at the correct value as supported by valuation certificates and/or invoices. We have considered the accounting treatment for particular unusual elements of this transaction (e.g. land swaps) by ensuring any such assets have been capitalised appropriately. We have confirmed that the project is properly recorded in the Authority's accounts as an Asset Under Construction. We have confirmed there are appropriate budget monitoring arrangements in place. There are no matters from our work which we need to draw to your attention.

Significant audit risks (continued)

Considerations required by professional standards

Fraud risk of revenue recognition

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

In our *External Audit Plan 2016/17* we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue.

This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.

Management override of controls

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

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

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

There are no matters arising from this work that we need to bring to your attention.

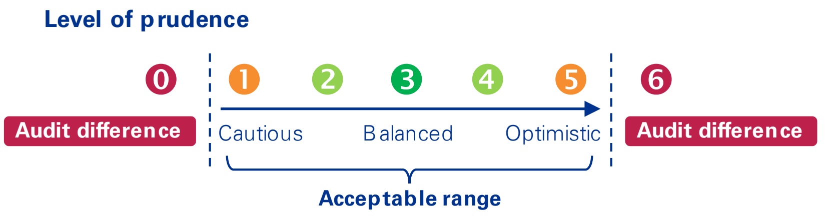
Other areas of audit focus

We identified three areas of audit focus. This is not considered a significant risk as it is less likely to give rise to a material error. Nonetheless this is an area of importance where we would carry out substantive audit procedures to ensure that there is no risk of material misstatement.

Other areas of audit focus	Our work to address the areas
1. Disclosures associated with retrospective restatement of CIES, EFA and MiRS	**Background** CIPFA has introduced changes to the 2016-17 Local Government Accounting Code (Code): — Allowing local authorities to report on the same basis as they are organised by removing the requirement for the Service Reporting Code of Practice (SeRCOP) to be applied to the Comprehensive Income and Expenditure Statement (CIES); and — Introducing an Expenditure and Funding Analysis (EFA) which provides a direct reconciliation between the way local authorities are funded and prepare their budget and the CIES. This analysis is supported by a streamlined Movement in Reserves Statement (MiRS) and replaces the current segmental reporting note. The Authority was required to make a retrospective restatement of its CIES (cost of services) and the MiRS. New disclosure requirements and restatement of accounts require compliance with relevant guidance and correct application of applicable accounting standards. **What we have done** For the restatement, we have obtained an understanding of the methodology used to prepare the revised statements. We have also ensured compliance with new disclosure requirements and found no issues to note.
3. Provision for business rate appeals	**Background** The level of unsettled business rates appeals had not significantly reduced nationally and there was the continuing risk that the amounts set aside as provisions may not be adequate. The provision at 31/3/16 (£2.7m) was material. **What we have done** We reviewed the basis of the 2016/17 provision and concluded that it was not materially misstated.

Judgements

We have considered the level of prudence within key judgements in your 2016-17 financial statements and accounting estimates. We have set out our view below across the following range of judgements.



Subjective areas	2016-17	2015-16	Commentary
Property, Plant and Equipment (PPE) valuations	3	3	Valuations are consistent with information provided by the external valuer. We have reviewed the arrangements and discussed the approach with managers. The Authority has not made any significant changes to its approach to asset lives or its valuation arrangements.
Non Domestic Rates provision	3	3	The Business Rate Appeals provision total of £3.3m (2015/16 £2.7m) is the largest element of the balance. We have not identified any material misstatement or further issues of concern for the Authority's attention.
Pensions liability	3	3	There have been no significant changes in the approaches to determining the estimate. The Authority has again relied on an independent expert actuarial valuation for its estimates. We did not identify any concerns regarding the Authority's approach or the assumptions used. The reported balance, together with assumptions and disclosures for inflation, discount rate, salary growth, life expectancy etc. are consistent with the report from the external actuary.
Debtors Impairment provision	3	3	The largest elements of the balance are the General Fund Bad Debt provision (£1.8m) and the HRA Bad Debt Provision (£1.5m). There have been no significant changes in the approaches to determining the estimate. The change in the level of the provision on the previous year is not material.

Proposed opinion and audit differences

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's 2016-17 financial statements following approval of the Statement of Accounts by the Council on 26 September 2017.

Audit differences

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

The final materiality (see Appendix 3 for more information on materiality) level for this year's audit was set at £2.0m. Audit differences below £100,000 are not considered significant.

Our audit identified significant audit differences, which we set out in Appendix 2. It is our understanding that these will be adjusted in the final version of the financial statements.

The tables on the right illustrate the total impact of audit differences on the Authority's movements on the General Fund and HRA for the year and balance sheet as at 31 March 2017. The net impact of the adjustments is a reduction in the Authority's balance sheet net worth of £4.5m, although the General Fund, HRA and other useable balances are unchanged.

In addition, we identified a number of presentational adjustments required to ensure that the accounts are compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 ('the Code'). We understand that the Authority will be addressing these where significant. The key changes are summarised at Appendix 2.

Movements on the General Fund 2016/17

£m	Pre-audit	Post-audit
(Surplus)/Deficit on the provision of services	(8.7)	(2.7)
Adjustments between accounting basis and funding basis under Regulations	9.3	3.3
Transfers to/(from) earmarked reserves	(0.9)	(0.9)
(Increase)/Decrease in General Fund	**(0.3)**	**(0.3)**

Movements on the HRA 2016/17

£m	Pre-audit	Post-audit
(Surplus)/Deficit on the provision of services	(49.1)	(53.5)
Adjustments between accounting basis and funding basis under Regulations	48.9	53.3
Transfers [to/from] earmarked reserves	0.1	0.1
(Increase)/Decrease in HRA	**(0.1)**	**(0.1)**

Balance sheet as at 31 March 2017

£m	Pre-audit	Post-audit
Property, plant and equipment	317.4	312.4
Other long term assets	16.2	15.2
Current assets	41.8	41.9
Current liabilities	(16.2)	(14.8)
Long term liabilities	(165.0)	(165.0)
Net worth	**194.2**	**189.7**
General Fund	(2.3)	(2.3)
HRA	(1.1)	(1.1)
Other usable reserves	(31.1)	(31.1)
Unusable reserves	(159.7)	(155.2)
Total reserves	**(194.2)**	**(189.7)**

Annual governance statement

We have reviewed the Authority's final 2016-17 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.

Narrative report

We have reviewed the Authority's final 2016-17 narrative report and have confirmed that it is consistent with the financial statements and our understanding of the Authority.

Accounts production and audit process

Auditing standards (*ISA 260*) require us to communicate our views on the significant qualitative aspects of the Authority's accounting practices and financial reporting.

We assessed the Authority's process for preparing the accounts and its support for an efficient audit. The efficient production of the financial statements and good-quality working papers are critical to meeting the tighter deadlines.

Accounting practices and financial reporting

The Authority's accountancy team experienced some turnover and other unplanned key staff absences in the first half of 2017, and resulting pressure on staff during the busy year-end period. The team managed to prepare a complete set of draft financial statements by the statutory deadline, with the statements published on 30 June 2017.

The team is aware of the much earlier 31 May deadline for 2017-18. In a year without the exceptional staffing difficulties experienced this year the team's year-end procedures and accounting practices would normally be sufficiently effective to meet this deadline. It is important that the Authority takes the steps necessary to re-establish robust arrangements and staffing to support the 2017-18 year-end. We have raised a recommendation relating to this area of improvement at Appendix 1.

Quality of supporting working papers

Our *Accounts Audit Protocol 2016-17* ("Prepared by Client" request) outlined our documentation request. The working papers were this year generally not as clear or comprehensive as in previous years, with the documents supplied to support the PPE and Collection Fund entries particularly weak. We have raised a recommendation relating to this area of improvement at Appendix 1.

Response to audit queries

The finance team responded promptly during the audit to our requests for additional information or explanation.

Controls over key financial systems

We have tested controls as part of our focus on significant audit risks and other parts of your key financial systems on which we rely as part of our audit. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

We have assessed the effectiveness of your key financial system controls, on which we rely as part of our audit. We found that the financial controls on which we seek to place reliance are operating effectively.

We have made a control observation at Appendix 1 regarding the Authority's controls for authorisation of journals.

Prior year recommendations

As part of our audit we have followed up the Authority's progress in addressing the recommendations in last year's ISA 260 report. Appendix 1 provides further details on this.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's 2016/17 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 City of Lincoln Council for the year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and City of Lincoln Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 4 in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Responsible Finance Office for presentation to the Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

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

- Significant difficulties encountered during the audit;
- Significant matters arising from the audit that were discussed, or subject to correspondence with management;
- Other matters, if arising from the audit that, in the auditor's professional judgement, 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.).

We have the following matters to report under this heading:

- Significant difficulties - During the July 2017 audit of the PPE accounting entries we identified a number of errors and inconsistencies in the supporting working papers. We agreed with management to suspend our work to allow them to review these entries and make corrections to the accounts and working papers. Our original work could not be relied upon and we returned to the Council at the end of August 2017 to repeat the previously carried out procedures and to complete the remaining audit work. We identified a material error during this work and these have been reported at Appendix 2. The abortive and unplanned additional work cannot be accommodated within the fee set at the start of the year. At Appendix 5 we have reported that we will need to apply to Public Sector Audit Appointments Ltd for an additional fee to cover the cost of this work.
- Internal Control - We have made a control observation at Appendix 1 regarding the Authority's controls for authorisation of journals.

There are no others matters which we wish to draw to your attention in addition to those highlighted above.

Section two

Value for money

Our 2016/17 VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions, worked with partners and other third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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

VFM conclusion

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

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

Our VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions, worked with partners and other third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We follow a risk based approach to target audit effort on the areas of greatest audit risk.

1 Identification of significant VFM risks (if any)

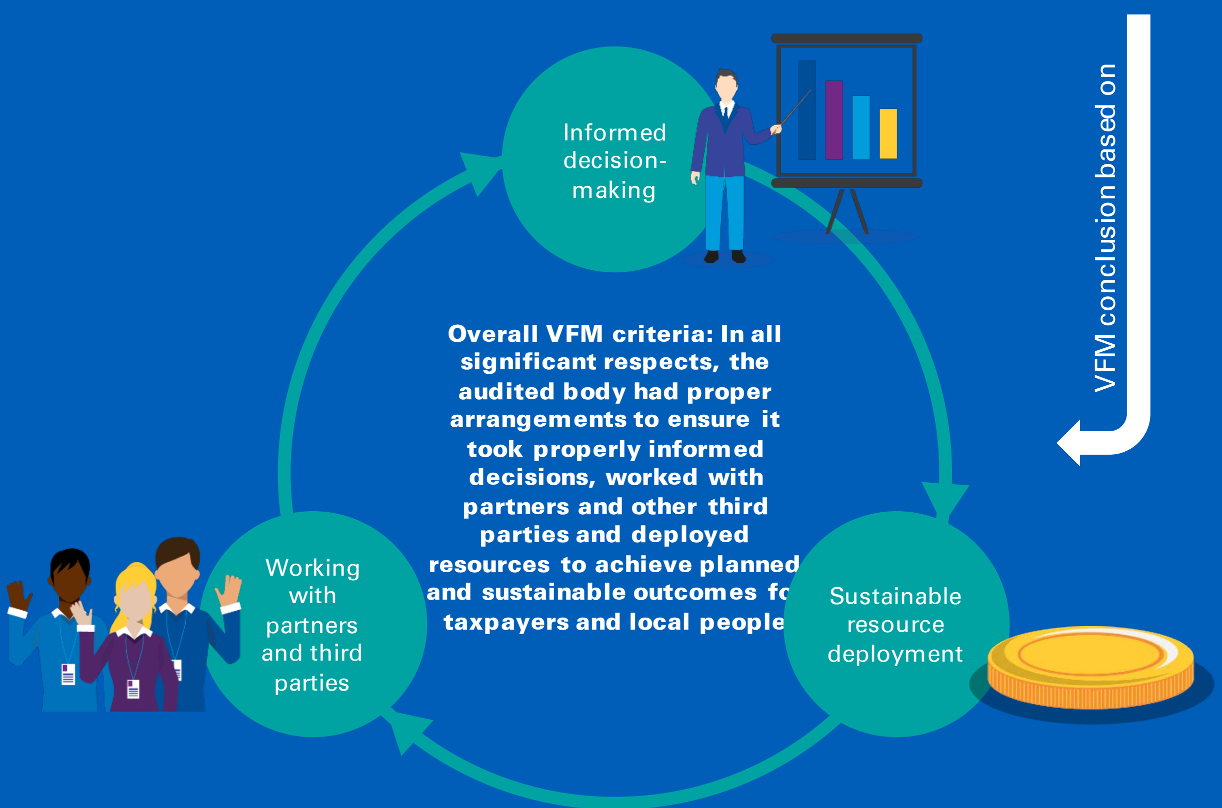
- VFM audit risk assessment
- Financial statements and other audit work

2 Continually re-assess potential VFM risks

- Assessment of work by other review agencies
- Specific local risk-based work

3 VFM conclusion

- **Conclude on arrangements to secure VFM**



The table below summarises our assessment of the significant VFM risk and other area of focus identified from our planning risk assessment. This directly feeds into the overall VFM criteria and our value for money opinion.

VFM assessment summary

VFM risk	Informed decision-making	Sustainable resource deployment	Working with partners and third parties
Significant VFM Risk - The Transport Hub and other high risk projects	✓	✓	✓
Risk factor - Financial resilience		✓	
Overall summary	✓	✓	✓

In consideration of the above, we have concluded that in 2016-17, the Authority has made proper arrangements to ensure it took properly-informed decisions, worked with partners and other third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Further details on the work done and our assessment are provided on the following pages.

VFM risk assessment

We identified one significant risk and one area of focus from our VFM risk assessment, as communicated to you in our *2016-17 External Audit Plan*. We are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk factors are adequate and no additional significant VFM risks have been identified.

Significant VFM risk and area of focus	Work performed
1. The Transport Hub and other high risk projects	The £30m Transport Hub project commenced in August 2016 and there are other large scale and high risk projects in progress or in planning. The Authority needs to continue to have adequate arrangements for managing the delivery and financial control of these projects. This is relevant to all three sub-criteria of the VFM conclusion. We have assessed the management arrangements in place, and specifically reviewed the frameworks relating to the delivery of the Transport Hub, Boultham Park Restoration and Western Growth Corridor projects. We have also considered the most recent progress in relation these projects and the Authority's latest project risk registers. We are satisfied that there were adequate arrangements in place at 31 March 2017 and there are no significant matters which prevent us from giving an unqualified VFM conclusion.
2. Financial resilience	The Authority continues to face similar financial pressures and uncertainties to those experienced by others in the local government sector. The Authority needs to have effective arrangements in place for managing its annual budget, generating income and identifying and implementing any savings required to balance its medium term financial plan. This is relevant to the sustainable resource deployment sub-criteria of the VFM conclusion. We have considered the Authority's arrangements for managing its annual revenue and capital budgets and the 2016/17 outturn. The General Fund and Housing Revenue Account revenue outturns were largely as expected and the Authority exceeded the £3m 'Towards Financial Sustainability (TFS) programme savings target included in the Medium Term Financial Strategy (MTFS) for 2016/17. No significant concerns have been highlighted to date in the current year monitoring reports. In February 2017, the Council approved the 2017/18 Budget and MTFS 2017-2022. The MTFS reflects the Government's four year funding settlement with the Council. The Authority has set a balanced budget for 2017/18, and was in a good position to deliver the £49k in year savings required under the TFS programme. The TFS programme was not expected though to deliver the level of savings required over the life of the MTFS with a gap of £719k in 2018/19. The MTFS acknowledges that there needs to be strong emphasis on achieving the savings targets from 2018/19 onwards and provide financial capacity to respond to the financial risks the Council faces. The Authority needs to continue to closely monitor progress in all these areas and ensure its MTFS is kept up to date.

Appendices

Key issues and recommendations

Our audit work on the Authority's 2016-17 financial statements has identified a number of issues. We have listed these issues in this appendix together with our recommendations.

The Authority should closely monitor progress in addressing the risks, including the implementation of our recommendations. We will formally follow up these recommendations next year.

We have also followed up progress made in relation to the recommendation made in 2015/16

Each issue and recommendation have been given a priority rating, which is explained below.

High priority — 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.

Medium priority — 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.

Low priority — Issues that would, if corrected, improve internal control in general but are not vital to the overall system. These are generally issues of good practice that we feel would benefit if introduced.

The following is a summary of the issues and recommendations raised in 2016/17 and the previous year.

Recommendations summary

Priority	Total raised in 2015/16	Total raised for 2016/17
High	0	1
Medium	1	0
Low	1	1
Total	2	2

Previous year's recommendation

We made two recommendations in our 2015/16 ISA260 Report:

Medium priority

Depreciation of Council Dwellings

We noted that the Authority's accounting policy for depreciating non-structural elements of Council Dwellings had been in place for a number of years, was regarded as a prudent approach, but was a departure from the CIPFA Code of Practice. We recommended the Authority disclose this departure from the Code within its accounting policies and keep this policy under review to ensure it continues to be appropriate for the Authority's needs.

Follow up 2016/17

The Authority has disclosed the departure from the Code within its accounting policies and, following its review, has continued to apply it.

Low priority

Quality of Working Papers

We noted that although working papers had improved the documents to support the mapping of the trial balance to the financial statements were still difficult to follow. We recommended that managers continue to look at these arrangements to establish whether any further improvements are possible.

Follow up 2016/17

We have again identified weaknesses in the quality of the supporting working papers. We have made another recommendation arising from our 2016/17 audit.

Current year's recommendation

High priority

Production of draft accounts and working papers

The Authority's accountancy team experienced some turnover and other unplanned key staff absences in the first half of 2017, and resulting pressure on staff during the busy year-end period. The team managed to prepare a complete set of draft financial statements by the statutory deadline, with the statements published on 30 June 2017.

During the final accounts audit we experienced the following difficulties:

- The working papers were this year generally not as clear or comprehensive as in previous years. The documents supplied to support the PPE and Collection Fund entries were particularly weak (these were two areas where staffing difficulties had been most severe).
- The errors and inconsistencies in the PPE supporting working papers were so widespread that we agreed with management to suspend our work to allow them to review these entries and make corrections to the accounts and working papers. Our original work could not be relied upon and we returned to the Council at the end of August 2017 to repeat the previously carried out procedures and to complete the remaining audit work. We identified material errors during this work and these have been reported at Appendix 2.

It is important that the Authority takes the steps necessary to re-establish robust arrangements and staffing to support the 2017-18 year-end.

Recommendation

Managers should:

- Ensure there are sufficient staff with relevant experience to support the 2017-18 year end:
- Given the level of PPE related errors identified this year, ensure its accounting procedures and records in this area are robust; and
- Critically review arrangements for preparing and quality assuring its supporting working papers before the 2017/18 year-end and discuss its proposals with KPMG before the draft financial statements are produced.

Management Response

2016/17 was an unprecedented year with 3 key positions absent during the final accounts period. The Council has since recruited to 2 of these and has put robust interim arrangements in place for the third key position. We will critically review processes and procedures in the coming year to ensure we have robust arrangements back in place for the 2017/18 year-end.

Current year's recommendation

Medium priority

Internal Control observations

We have the following observations arising from our audit work to make on the Authority's internal controls

- Timeliness of Bank Reconciliation review - the October 2016 bank reconciliation was signed as prepared 23/11/16 but not signed as reviewed by the relevant manager until 4/1/17.
- General Ledger Journal approval - there is no system enforced independent approval of Journals and no other compensating control beyond budgetary control.

Recommendation

Managers should:

- Ensure bank and other system reconciliations are reviewed on a timely basis: and
- Consider the risks in the current journal approval arrangements and the scope for introducing any additional compensating controls.

Management Response

A performance target for bank reconciliations is to be introduced during 2017 so that reconciliations up to 31st of the previous month are completed and authorised by a manager by the end of the following month. With regards to journals - the most frequent and high value journals are cash book journals - a compensating control is that the monthly bank reconciliation would identify any miscodings or missing journals, other journal postings would be picked up during regular budget monitoring which takes place quarterly. In addition the ability to post journals is limited to Financial Services.

Appendix 2

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. We are also required to report all material misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities.

Corrected audit differences

We identified material audit differences this year which affects the Balance Sheet (the Property Plant and Equipment (PPE), and Unusable Reserves balances), the CIES and the MIRS. The significant differences are summarised in table 1 below. The largest difference relates to omission of the 31/03/2017 Council Dwelling revaluations from the draft accounts. We also identified an error close to our £1.5m materiality level, relating to the incorrect posting of a debtor against the creditors balance. It is our understanding that these audit differences will be adjusted.

Table 1: Adjusted audit differences (£'000)

No.	Comprehensive Income and expenditure statement (CIES)	Movement in reserves statement	Assets	Liabilities	Reserves	Basis of audit difference
1		Note 10 Transfers in and out of Housing Repairs Account Dr 8,083 Cr 8,083				Incorrect "Transfer in" value for HRA Repairs Account
2	Depreciation w/o to the CIES Cr 10,710		Note 14 – PPE – Depreciation w/o to the CIES Dr 10,710			Omission of the 31/03/17 Council Dwelling revaluations from the accounts
	Revaluation loss charged to the CIES Dr 5,224		Note 14 – PPE Revaluations recognised in the CIES Cr 5,224			
		Note 7a HRA capital Dr 5,496			CAA Cr 5,486	
3			Cr s/t debtors 1,469	Dr s/t creditors 1,469		Incorrect posting of Housing Pooling debtor against creditors balance

Uncorrected audit differences

There are no uncorrected audit differences that we need to report to you.

Corrected audit differences

Our audit identified a small number of non-material errors in the disclosure notes to the financial statements. Management has agreed to amend the financial statements for all of them. There are no changes to the values included in the primary statements. The amendments include:

Note 10 – Movements on earmarked reserves – to show the correct analysis of movements.
Note 18 - Financial Instruments – virtually all of these disclosures were incorrect and needed to be amended.
Note 20 – Debtors – to show the correct analysis.
Note 28/48 – Cash Flow – to show the correct disclosure of cash flow movements.
Note 35 – Officer's remuneration – to correct salary and pension disclosures.
Note 36 – Audit Fees – to show the correct analysis.

Materiality and reporting of audit differences

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

Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.

Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.

Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We used the same planning materiality reported in our External Audit Plan 2016-17, presented to you in March 2017.

Materiality for the Authority's accounts was set at £2.0m which equates to around 1.8% percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit Committee and the Council

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

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

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

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £100,000 for the Authority.

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

Declaration of independence and objectivity

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice (the 'Code') which states that:

> *"The auditor should carry out their work with integrity, objectivity and independence, and in accordance with the ethical framework applicable to auditors, including the ethical standards for auditors set by the Financial Reporting Council, and any additional requirements set out by the auditor's recognised supervisory body, or any other body charged with oversight of the auditor's independence. The auditor should be, and should be seen to be, impartial and independent. Accordingly, the auditor should not carry out any other work for an audited body if that work would impair their independence in carrying out any of their statutory duties, or might reasonably be perceived as doing so."*

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Public Sector Audit Appointments Ltd Terms of Appointment ('Public Sector Audit Appointments Ltd Guidance') and the requirements of APB Ethical Standard 1 Integrity, Objectivity and Independence ('Ethical Standards').

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

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

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from this. These matters should be discussed with the Audit Committee.

Ethical Standards require us to communicate to those charged with governance in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on our independence and the objectivity of the Engagement Lead and the audit team.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Partners and staff annually confirm their compliance with our Ethics and Independence Manual including in particular that they have no prohibited shareholdings.

Our Ethics and Independence Manual is fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through: Instilling professional values, Communications, Internal accountability, Risk management and Independent reviews.

We would be happy to discuss any of these aspects of our procedures in more detail.

Auditor declaration

In relation to the audit of the financial statements of City of Lincoln Council for the financial year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and City of Lincoln Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Non-audit work and independence

Below we have listed the non-audit work performed and set out how we have considered and mitigated (where necessary) potential threats to our independence.

Summary of non-audit work		
Description of non-audit service	**Estimated fee**	**Potential threat to auditor independence and associated safeguards in place**
Certification of the Pooling of Housing Receipts	£3,000	**Self-interest**: This engagement is entirely separate from the audit and there is a separate engagement letter in place. **Self-review:** The nature of this work is to certify the Pooling of Housing Receipts in accordance with the specific assurance instructions set out by DCLG in CFB06. It does not impact on our opinion and we do not consider that the outcome of this work will be a threat to our role as external auditors. **Management threat:** This work will being undertaken in accordance with the Assurance Instruction CFB06 provided by DCLG. **Familiarity**: This threat is limited given the scale, nature and timing of the work. **Advocacy**: We will not act as advocates for the Authority in any aspect of this work. We report our findings directly to DCLG. **Intimidation**: Not applicable
Total estimated fees	**£3,000**	
Total estimated fees as a percentage of the external audit fees	**6%**	

Appendix 5

Audit fees

Audit fees

As communicated to you in our External Audit Plan 2016-17, our scale fee for the audit is £47,185 plus VAT *(£47,185 in 2015-16)*. However, we propose an additional fees due to:

- additional work required to complete the audit of PPE and the VFM conclusion; and
- further work required in relation to the CIES restatement.

Our work on the certification of Housing Benefits (BEN01) is planned for October 2017. The planned scale fee for this is £9,098 plus VAT, see further details below.

PSAA fee table		
Component of audit	**2016/17** *(planned fee)* £	**2015/16** *(actual fee)* £
Accounts opinion and use of resources work		
PSAA scale fee	47,185	47,185
Additional work to conclude our opinion and VFM conclusion (note 1)	TBC	1,591
Subtotal	**47,185***	**48,776**
Housing benefits (BEN01) certification work		
PSAA scale fee – planned for October 2017	9,098	10,570
Total fee for the Authority set by the PSAA	**56,283**	**59,346**

All fees are quoted exclusive of VAT.

Note 1: Accounts opinion and use of resources work

For 2016/17, we have discussed additional fee in relation to the further work on PPE, the VFM conclusion and the work undertaken in respect of the CIES restatement. These are still subject to final agreement and PSAA approval.

*** Does not include the additional fee re Note 1**