External Audit ISA260 Report 2017/18

City of Lincoln Council

July 2018

Summary for Audit Committee and the Council

Background

This document summarises the key findings in relation to our 2017-18 external audit at City of Lincoln Council ('the Authority').

This report covers both our on-site work which was completed in June and July 2018 on the Authority's significant risk areas, as well as other areas of your financial statements. The report is prepared for presentation at the Audit Committee 19 July 2018, and then at the Council meeting of 24 July 2018. We will update the Audit Committee at its meeting on any significant matters contained in this report.

Designation as an EU Public Interest Entity (EU PIE)

New European Union (EU) statutory audit legislation came into effect for all financial years starting on or after June 17, 2016. The new Public Interest Entity (PIE) definition includes organisations with transferable securities listed on EU regulated markets and governed by the law of an EU member.

The Authority has around £561,000 of listed debt on the London Stock Exchange (LSE). As a result of this listed debt, the Authority now falls under the definition of an EU PIE. The implications for our audit were set out in the *External Audit Plan 2017-18* issued in May 2018. We have complied with these requirements during our audit. We have met the additional reporting requirements relevant to this report and we are drafting the newly required Long Form Audit Report (which includes our audit opinion) which will need to be included with the published final financial statements.

Financial statements

Subject to completion of the remaining work and 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 31 July 2018.

The remaining audit work includes the following matters:

- Final Audit Director and Engagement Quality Review Partner review;
- Addressing any remaining audit queries, obtaining required information from third parties and any further 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.

Based upon our initial assessment of risks to the financial statements (as reported to you in our *External Audit Plan 2017/18* and updated during our audit) we identified the following significant risks (excluding those mandated by International Standards on Auditing):

— **Valuation of PPE** – the Authority operates a cyclical revaluation approach and we considered the way in which the Authority ensures that assets not subject to in-year revaluation are not materially misstated;

— **Pensions Liabilities** – we reviewed the processes in place to ensure accuracy of data provided to the Actuary and considered the assumptions used by the Actuary in determining the valuation;

— **Faster Close -** the timetable for the production of the financial statements has been significantly advanced and we worked with the Authority in advance of our audit to understand the steps being taken to meet these deadlines and the impact on our work.

Summary for Audit Committee and the Council (cont.)

Financial statements (continued)

There are no audit adjustments arising from our work that we need to report to you. There is one non-material unadjusted audit difference (Appendix 3)

We are now in the completion stage of the audit and anticipate issuing our completion certificate alongside the audit opinion and VFM conclusion before 31 July 2018. We expect to issue our Annual Audit letter before the end of September 2018.

Control Environment

We have assessed the effectiveness of your key organisational and financial system controls, on which we rely as part of our audit. We identified one control point as part of that work and have included more information on this in Appendix 1. Overall we found that the controls on which we seek to place reliance are operating effectively.

Value for money arrangements

We have completed our risk-based work to consider whether in all significant respects the Authority has proper arrangements to ensure 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.

We set out our assessment of those areas requiring additional risk based work in our *External Audit Plan 2017/18* and have updated this assessment during our interim visit. We identified the following significant VFM audit risks:

— **Financial resilience** – As a result of reductions in central government funding, and other pressures, the Authority continues to face similar financial pressures and uncertainties to those experienced by others in the local government sector. We considered the arrangements the Authority had in place for managing its annual budget, generating income and identifying and implementing any savings required to balance its medium term financial plan.

— **Major projects** - The Authority continues to have a number of major projects in progress which are relatively high risk. These include the final stages of the Transport Hub and Boultham Park projects and the Western Growth Corridor project, which is complex and of significant strategic importance to the Authority. We considered the arrangements the Authority has in place managing the delivery and financial control of these projects.

See further details on page 18.

Exercising of audit powers

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 not identified any matters that would require us to issue a public interest report.

In addition, we have not had to exercise any other audit powers under the Local Audit & Accountability Act 2014.

Acknowledgements

We would like to take this opportunity to thank officers and Members for their continuing help during this year's audit.

Section one

Control Environment

Organisational and IT control environment

We have identified no significant issues with the Authority's control environment and consider that the overall arrangements that have been put in place are reasonable.

Organisational control environment

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.

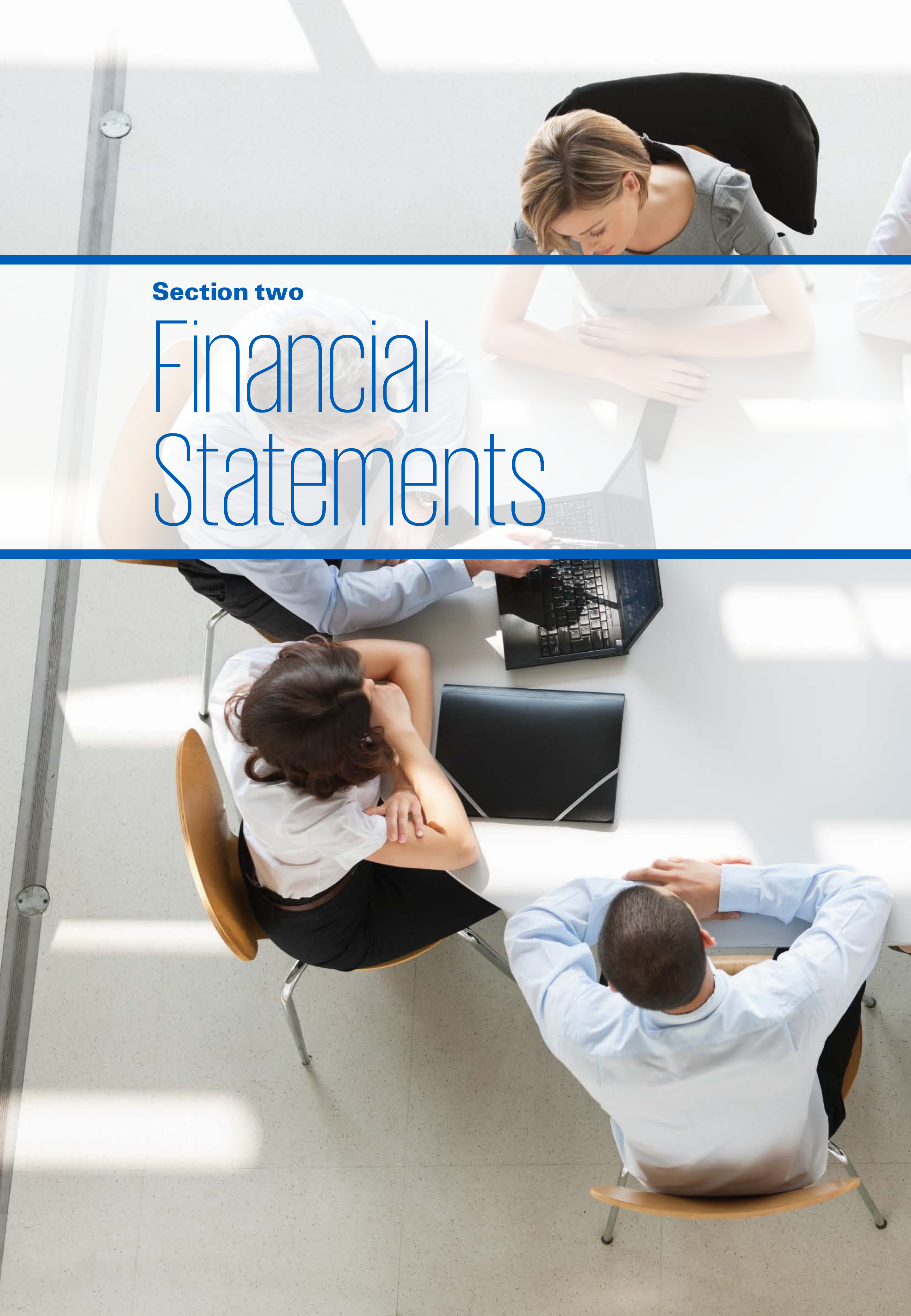
Controls over key financial systems

We have assessed the design and/or operation of certain key 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 financial system 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. This included a review of the General IT Controls around the General Ledger and Payroll systems. We identified one low priority control point as part of that work and have included more information on this in Appendix 1. Overall we found that the financial controls on which we seek to place reliance are operating effectively.

Section two

Financial Statements



Accounts production and audit process

Audit standards (ISA 260) require us to communicate our views on 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. The efficient production of the financial statements and good-quality working papers was critical to meeting the tighter deadlines this year.

The Authority's overall process for the preparation of the financial statements and supporting working papers was much improved on the previous year.

Accounts practices and production process

The Authority published a complete set of draft accounts by 31 May 2018. We consider that the overall process for the preparation of your financial statements was much improved on the previous year. We also consider the Authority's accounting practices appropriate.

Going concern

The financial statements of the Authority have been prepared on a going concern basis. We confirm that we have identified no significant matters which would, in our view, affect the ability of the Authority to continue as a going concern.

Implementation of recommendations

We raised two recommendations in our ISA 260 Report 2016/17, both of which have been implemented. Further details are included in Appendix 2.

Completeness of draft accounts

The Authority published a complete set of draft accounts on 31 May 3018, which is the statutory deadline.

Quality of supporting working papers

We issued our Accounts Audit Protocol to officers before the start of the audit. This important document sets out our audit approach and timetable. It also summarises the working papers and other evidence we require the Authority to provide to support our audit work. This helps the Authority to provide audit evidence in line with our expectations.

The working papers provided this year have been of a good standard. The requested working papers were available at the start of the audit visit and the finance team responded promptly to any requests for additional information or explanation.

Response to audit queries

Finance staff were available throughout the audit visit to answer our queries and the queries were responded to promptly. We thank the finance team for their co-operation throughout the visit which allowed the audit to progress within the allocated timeframe.

Specific audit areas

We anticipate issuing an unqualified audit opinion on the Authority's 2017-18 financial statements by 31 July 2018.

Auditing standards require us to consider two standard risks for all organisations. We consider these as a matter of course in our audit and will have set out the findings arising from our work in our ISA 260 Report below.

01

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.

02

Fraudulent 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 2017-18* 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.

Specific audit areas

Significant Audit Risks – Authority

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error in relation to the Authority.

Risk:	**Valuation of PPE** The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Authority has adopted, for assets valued internally, a rolling revaluation model which sees all land and buildings revalued over a five year cycle. As a result of this, however, individual assets may not be revalued for four years. This creates a risk that the carrying value of those assets not revalued in year differs materially from the year end fair value. Alongside this the Transport Hub (car park and bus station) have come into operation during 2017/18. These assets are material and its important that the initial valuation and accounting is properly carried out.
Our assessment and work undertaken:	We reviewed the approach that the Authority has adopted to address the risk that assets not subject to valuation are materially misstated and considered the robustness of that approach. In relation to those assets which have been revalued during the year we reviewed the accounting entries made to record the results of the revaluation in order to ensure that they were appropriate. We assessed the internal valuer's qualifications, objectivity and independence to carry out such valuations and engaged a KPMG valuer to review the methodology used. We also reviewed the initial accounting and valuation for the Transport Hub assets in order to confirm it confirms with relevant guidance. Some elements of this work are still in progress at the date of this report. For example we are clearing a small number of queries raised with the Authority's valuer. Subject to completion of the remaining work and all outstanding queries being resolved to our satisfaction we are satisfied that the PPE assets reviewed were not materially misstated.

Specific audit areas (cont.)

Significant Audit Risks – Authority (cont.)

Risk:	**Pension Liabilities** The net pension liability represents a material element of the Authority's balance sheet. The Authority is an admitted body of Lincolnshire Local Government Pension Fund, which had its last triennial valuation completed as at 31 March 2016. This forms an integral basis of the valuation as at 31 March 2018. The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Authority's overall valuation. There are financial assumptions and demographic assumptions used in the calculation of the Authority's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should also reflect the profile of the Authority's employees, and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes. There is a risk that the assumptions and methodology used in the valuation of the Authority's pension obligation are not reasonable. This could have a material impact on the net pension liability accounted for in the financial statements.
Our assessment and work undertaken:	As part of our work we liaised with the Authority to understand and review the controls that are in place over the information sent directly to the Scheme Actuary. We also liaised with the auditors of the Pension Fund in order to gain an understanding of the effectiveness of the arrangements operated by the Pension Fund. We reviewed the appropriateness of the key assumptions included within the valuation, compared them to expected ranges and involved a KPMG Actuary to provide a specialist assessment of those assumptions. We also evaluated the competency, objectivity and independence of Fund's actuary, Hymans Robertson, and reviewed the methodology applied in their valuation We reviewed the overall Actuarial valuation report obtained and considered the disclosure implications in the financial statements. In order to determine whether the net pension liability has been appropriately accounted for we also considered the valuation of pension assets. We obtained assurance from the Pension Fund auditors over the overall value of fund assets. We then liaised with the actuary to understand how these assets are allocated across participating bodies. Some elements of this work are still in progress at the date of this report. For example, we have not yet had a full response from the Lincolnshire Pension Fund auditors to our enquiries. Subject to completion of the remaining work and all outstanding queries being resolved to our satisfaction As a result of this work we determined that the net pension liability had been properly accounted for and disclosed in the financial statements.

Specific audit areas (cont.)

Significant Audit Risks – Authority (cont.)

Risk:

Faster Close

In prior years, the Authority has been required to prepare draft financial statements by 30 June and then final signed accounts by 30 September. For years ending on and after 31 March 2018 however, revised deadlines apply which require draft accounts by 31 May and final signed accounts by 31 July.

During 2016/17 the Authority's accountancy team experienced some turnover and other unplanned key staff absences resulting in pressure on staff during the busy year-end period. The team managed to prepare a complete set of draft financial statements by the 30 June 2017 deadline but the working papers were generally not as clear or comprehensive as in previous years and identified material errors in the accounts. Further work is therefore required in order to re-establish robust arrangements and staffing to ensure that the statutory deadlines for 2017/18 are met.

In order to meet the revised deadlines, the Authority may need to make greater use of accounting estimates. In doing so, consideration will need to be given to ensuring that these estimates remain valid at the point of finalising the financial statements. In addition, there are a number of logistical challenges that will need to be managed. These include:

— Ensuring that any third parties involved in the production of the accounts (including valuers and actuaries) are aware of the revised deadlines and have made arrangements to provide the output of their work in accordance with this;

— Revising the closedown and accounts production timetable in order to ensure that all working papers and other supporting documentation are available at the start of the audit process;

— Ensuring that the Audit Committee meeting schedules have been updated to permit signing in July; and

— Applying a shorter paper deadline to the July meeting of the Audit Committee meeting in order to accommodate the production of the final version of the accounts and our ISA 260 report.

In the event that the above areas are not effectively managed there is a significant risk that the audit will not be completed by the 31 July deadline.

There is also an increased likelihood that the Audit Certificate (which confirms that all audit work for the year has been completed) may be issued separately at a later date if work is still ongoing in relation to the Authority's Whole of Government Accounts return. This is not a matter of concern and is not seen as a breach of deadlines.

Our assessment and work undertaken:

We liaised with officers in preparation for our audit in order to understand the steps that the Authority was taking in order to ensure it met the revised deadlines and the accounts and supporting working papers were of the required quality. We confirmed that there was no increased reliance on estimates as part of the closedown process. We confirmed that the Authority published a complete set of draft financial statements on 31 May 2018. There were difficulties in us being able to obtain required audit information from third parties but this is not a reflection on the Authority's arrangements.

As a result of this work we determined that the Authority had met the earlier financial reporting requirement.

Specific audit areas (cont.)

Other areas of audit focus

Those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding.

Issue:

Designation as an EU Public Interest Entity (EU PIE)

The new European Union (EU) statutory audit legislation came into effect for all financial years starting on or after June 17, 2016. The new Public Interest Entity (PIE) definition includes organisations with transferable securities listed on EU regulated markets and governed by the law of an EU member. City of Lincoln Council has around £561,000 of listed debt on the London Stock Exchange (LSE).

As a result of this listed debt, the Authority now falls under the definition of an EU PIE. The implications of this for the audit were explained in our *External Audit Plan 2017-18* and specific briefing for the Audit Committee and are as follows:

- Mandatory firm rotation - under the new legislation the initial engagement period for a statutory auditor or audit firm should not be less than one year but not exceed 10 years. Tenure is counted from the start of the first accounting period audited and only during the period when the entity was considered to be a PIE.
- Prohibited non-audit services - the legislation includes a detailed list of non-audit services that audit firms and members of their networks may not provide to a PIE statutory audit client, its EU parent, or its EU controlled undertakings (subsidiaries).
- The role of the Audit Committee - the legislation includes several provisions designed to strengthen the audit committees of EU organisations and to provide more transparency into the activities of the committee and the statutory audit. Each PIE must have an audit committee composed of non-executive members and at least one member of the audit committee must have competence in accounting and/or auditing. The committee members as a whole should have competence relevant to the company's business sector
- Auditors' responsibilities - the legislation relating to auditor reporting includes a series of requirements that should enhance understanding of the audit process, including critical judgements made during the audit. The legislation contains detailed provisions affecting statutory audits and the way they are conducted. As an EU PIE, the Authority is subject to additional reporting requirements, and these were summarised in our *External Audit Plan 2017-18*.

Our assessment and work undertaken:

We have liaised with the Authority to ensure compliance with the requirements for an audit of an EU PIE, including the enhanced reporting requirements. We have complied with the requirements relating to firm rotation and non-audit services. We have briefed the Audit Committee on the implications of the Authority being an EU PIE and their impact on its role. We have complied with the additional reporting requirements, in this report and in our draft Long Form Audit Report (which includes our audit opinion) which will be included with the published final financial statements.

Judgements

We have considered the level of prudence within key judgements in your 2017-18 financial statements and accounting estimates. We have set out our view below across the following range of judgements.

Level of prudence

0	1	2	3	4	5	6
Audit Difference	Cautious		Balanced		Optimistic	**Audit Difference**
	Acceptable Range					

Subjective area	2017-18	2016-17	Commentary
Property, Plant and Equipment (PPE) valuations	3	3	Valuations are consistent with information provided by the independent expert valuers. 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.
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.
Business Rates Provision	3	3	The Business Rate Appeals provision total of £3.0m (2016/17 £3.3m) is the largest element of the balance. We have not identified any material misstatement or further issues of concern for the Authority's attention.
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 (£1.6m). 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 2017-18 financial statements following approval of the Statement of Accounts by the Council on 24 July 2018.

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 4) for this year's audit was set at £1 million. Audit differences below £50,000 are not considered significant.

We did not identify any material misstatements. There are no adjusted misstatements identified during our audit that we are required to report to you. There is one unadjusted misstatement we are required to report to you (Appendix 3). None of the audit adjustments agreed during our audit impact on the Authority's movements on the General Fund and Housing Revenue Account or the year and balance sheet as at 31 March 2018.

We identified a small number of presentational adjustments required to ensure that the accounts are compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2017-18 ('the Code'). These presentational adjustments were not significant and there are none that we are required to bring to your attention in this report.

Annual governance statement

We have reviewed the Authority's final 2017-18 Annual Governance Statement and confirmed that it is not misleading and is consistent with other information we are aware of from our audit of the financial statements.

Narrative report

We have reviewed the Authority's 2017-18 narrative report and have confirmed that it is consistent with the financial statements and our understanding of the Authority.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to the audit of the Authority's 2017/18 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 2018, 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 6 in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing, whether the transactions within the accounts are legal and unaffected by fraud, and your confirmation that you do not propose to adjust the financial statements to correct the audit difference identified at Appendix 3. We have provided a template to managers for presentation to the Audit Committee and the Council. 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 2017-18 financial statements.

Section three

Value for Money Arrangements

Specific value for money risk areas

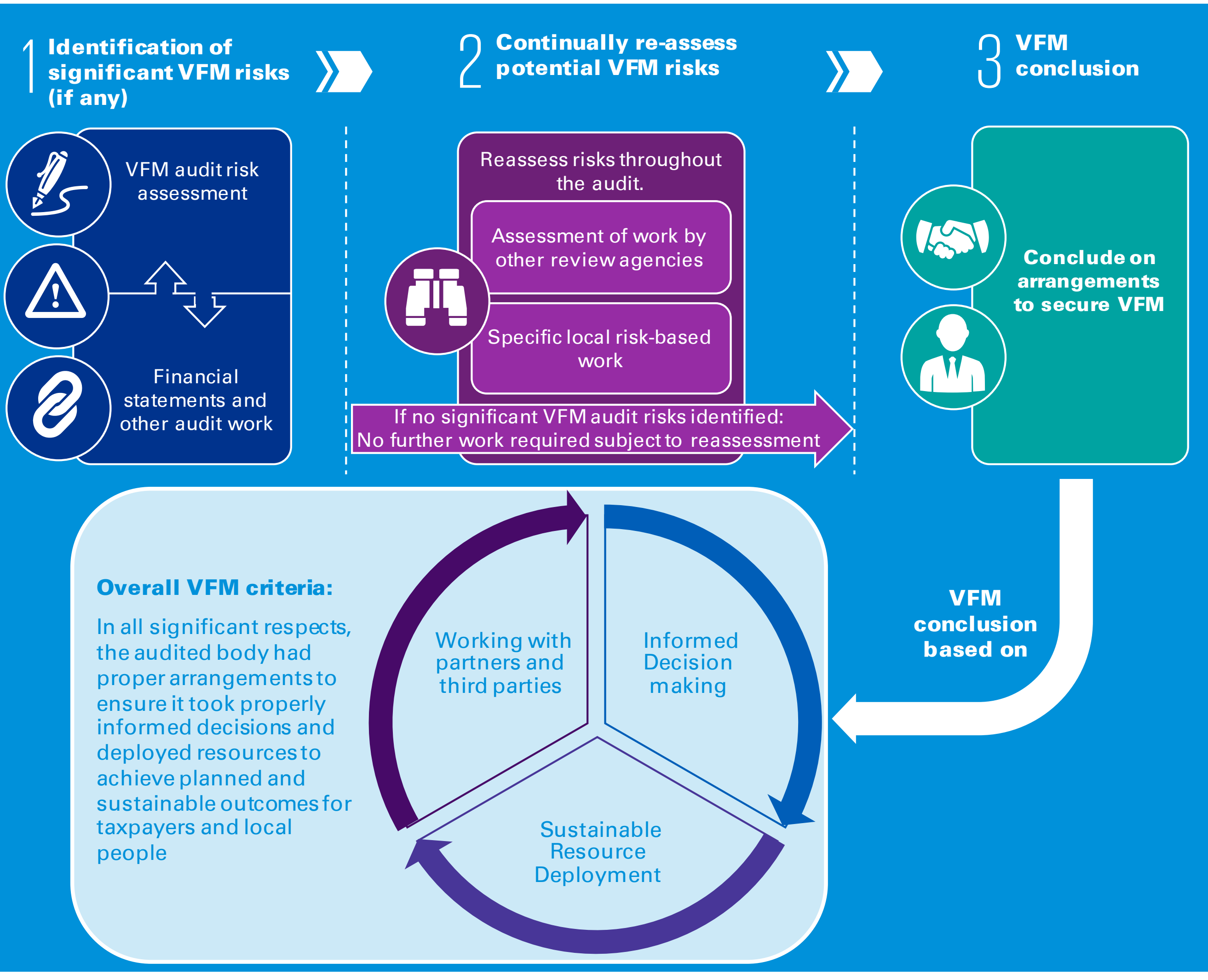
Our 2017-18 VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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

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

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

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



Specific value for money risk areas (cont.)

The table below summarises our assessment of the individual VFM risks identified against the three sub-criteria. This directly feeds into the overall VFM criteria and our value for money opinion.

Applicability of VFM Risks to VFM sub-criteria			
VFM Risk	**Informed decision making**	**Sustainable resource deployment**	**Working with partner and third parties**
Financial resilience			
Major projects			

In consideration of the above, we have concluded that in 2017-18, the Authority has made proper arrangements to ensure it took properly-informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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

Specific value for money risk areas (cont.)

As communicated to you in our *External Audit Plan 2017-18*, and as updated throughout the audit, we have identified two risks requiring specific audit attention and procedures to address the likelihood that proper arrangements are not in place to deliver value for money.

In all cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

We have provided below a summary of the risk areas identified, our work undertaken and the conclusions reached.

Financial Resilience

Risk: As a result of reductions in central government funding, and other pressures, 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.

Our work undertaken and assessment

As part of our additional risk based work, we reviewed the arrangements the Authority has in place in these areas and for ensuring its continuing financial resilience. We have considered the Authority's arrangements for managing its annual revenue and capital budgets and the 2017/18 outturn. The General Fund and Housing Revenue Account revenue outturns were largely as expected and the Authority exceeded the £3.5m 'Towards Financial Sustainability (TFS) programme savings target included in the Medium Term Financial Strategy (MTFS) for 2017/18.

A balanced budget was set for 2018/19. The TFS savings requirement for future years' has been reviewed and re-profiled. The savings 'gap' of £0.1m for 2018/19 has been largely addressed since the budget was agreed. Work is continuing on schemes and options for future years following the current successful strategy and areas of focus (including opportunities for commercialisation, asset utilisation and shared services). The requirement for future years is estimated at around £200k to £250k and acknowledged in the MTFS as a challenge. The Authority understands the need to continue to closely monitor progress in all these areas and ensure its MTFS is kept up to date.

We are satisfied that there were adequate arrangements in place at 31 March 2018 and there are no significant matters relating to this risk area which prevent us from giving an unqualified VFM conclusion.

Major Projects

The Authority continues to have a number of major projects in progress which are relatively high risk. These include the final stages of the Lincoln Transport Hub (LTH) and Boultham Park projects and the Western Growth Corridor (WGC) project, which is complex and of significant strategic importance to the Authority.

Our work undertaken and assessment

As part of our additional risk based work, we assessed your arrangements for managing the delivery and financial control of these projects. We also considered the most recent progress in relation these projects and the Authority's latest programme risk registers. The LTH and Boultham Park schemes were successfully delivered during the year and the specific Programme Board arrangements are no longer required. Although the final accounts for both schemes have not yet been audited, and there are some residual works to be completed on the LTH, there are no significant continuing issues which are relevant to our assessment. The WGC project continues to be a high risk project and the Programme Board arrangements have been consolidated during the year with close financial and operational control exercised. The spend to date continues to be met from revenue resources, which is appropriate at this stage. The cost to date is considerable,(£1.2m over the last two years and £0.2m budgeted in 2018/19) and is subject to the same financial procedure rules as other budgets. This is a strategically important project to the Authority and it is clear that this enabling expenditure is necessary to achieve its objectives. The programme has a high profile within the Council and there is regular progress reporting to members.

We are satisfied that there were adequate arrangements in place at 31 March 2018 and there are no significant matters relating to this risk area which prevent us from giving an unqualified VFM conclusion.

Appendices

Appendix 1:

Key issues and recommendations

We have made one recommendation arising from a control issue identified during our 2017-18 audit. We have summarised the issue, and management's response in the table below.

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

Priority Rating for Recommendations

1	**Priority One:** Issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk. Recommendations Raised: 0	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. Recommendations Raised: 0	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. Recommendations Raised: 1

No.	Risk	Issue & Recommendation	Management Response
1	1	We have assessed the effectiveness of your key financial system controls, on which we rely as part of our audit. This included a review of the General IT Controls around the General Ledger and Payroll systems. This covered, amongst other things, controls on access and programme changes. We identified one control point as part of that work: • User access rights for the Payroll system are not routinely reviewed by management, to ensure they are appropriate.. Whilst the control is not in place, we noted that the pool of staff using the system is small and the starters and leavers controls were operating effectively, and therefore there was no impact on the audit. ***Recommendation*** We recommend management consider further strengthening controls by regularly reviewing users' access rights to ensure they are appropriate.	Management intend to further strengthen the controls in 2018/19 by regularly reviewing the appropriateness of access rights to the payroll system, as per the audit recommendation. Robert Baxter Financial Services Manager

Appendix 2:

Follow-up of prior year recommendations

The Authority has implemented all of the recommendations raised through our previous audit work.

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2016/17*.

Number of recommendations that were	
Included in the original report	2
Implemented in year or superseded	2
Outstanding at the time of our interim audit	nil

No.	Risk	Issue & Recommendation	Management Response	Status as at July 2018
1	1	***Production of draft accounts and working papers*** During the 2016/17 final accounts audit we experienced a number of difficulties, due to material errors in the financial statements and poor working papers. These issues were attributed to exceptional staff shortages and turnover in the Authority's finance team during 2106/17 and the accounts closedown period. ***Recommendation*** • Ensure there are sufficient staff with relevant experience to support the 2017-18 year end: • Ensure its PPE accounting procedures and records are robust; and • Critically review arrangements for preparing and quality assuring its supporting working papers before the 2017/18 year-end.	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. ***Responsible Officer*** Rob Baxter – Acting CFO	The Authority has recruited to the vacant positions. We have found the financial reporting processes to be improved. No material errors have identified during this year's audit and the issues encountered in previous year (quality of accounts and working papers) have not been repeated this year.
2	2	***Control observations*** We made the following observations 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*** • 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.	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. ***Responsible Officer*** Rob Baxter – Acting CFO	The reconciliations we examined this year had all been completed when due and included evidence of manager review. The previous year's management response sets out their consideration of the risk identified (i.e. that the risk was considered to not be significant and that there were compensating controls in place).and no further controls proposed.

Appendix 3:

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.

Adjusted Audit Differences

There are no adjusted audit differences that we are required to report to you. During our audit a small number of amendments were identified as required to the supporting notes to the 2017-18 draft financial statements, to correct errors or to comply with the Code requirements. We understand the Finance team is to amend the statements for this matters and to update the Audit Committee on the changes made. We will review these amendments as part of our closing procedures and checks on the final set of the financial statements.

Unadjusted audit differences

The following table sets out the uncorrected audit differences above our reporting threshold (£50k) identified by our audit of the Authority's financial statements for the year ended 31 March 2018. These differences are individually below our materiality level of £1m. We have considered the impact of these unadjusted audit differences on the Authority's financial statements in forming our audit opinion.

Table 2: Unadjusted audit differences – Authority (£'000)

No.	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Basis of audit difference
1					CR 80 Capital Adjustment Account Dr 80 Revaluation Reserve	This asset (grazing land at Tritton Rd) has been transferred to Assets Held for Sale and then revalued upward by £80k. This revaluation should have been taken to the CAA and not the Revaluation Reserve.
	nil	**nil**	**nil**	**nil**	**nil**	**Total impact of adjustments**

Appendix 4:

Materiality

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

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

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

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

We updated materiality, reflecting the final reported position for the year, from the planning materiality reported in our *External Audit Plan 2017-18*, presented to you in May 2018.

Materiality for the Authority's accounts was set at £1 million (compared to the £1.1m proposed in our *External Audit Plan 2017-18)* which equates to around one 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 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, an individual difference is considered to be clearly trivial if it is less than £50,000 for the Authority.

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

Appendix 5:

Required communications with the Audit Committee and the Council

We have provided below at-a-glance summary of the information we are required to report to you in writing by International Accounting Standards.

Required Communication	Commentary
Our draft management representation letter	We have not requested any specific representations in addition to those areas normally covered by our standard representation letter for the year ended 31 March 2018.
Adjusted audit differences	There are no adjusted audit differences that we are required to report.
Unadjusted audit differences	There is one unadjusted audit difference reported at Appendix 3.
Related parties	There were no significant matters that arose during the audit in connection with the entity's related parties.
Other matters warranting attention by the Audit Committee	There were no matters to report arising from the audit that, in our professional judgment, are significant to the oversight of the financial reporting process.
Control deficiencies	We have set out our assessment of the Authority's internal control environment, including any control deficiencies in Section one of this report.
Actual or suspected fraud, noncompliance with laws or regulations or illegal acts	We identified no actual or suspected fraud involving the Authority's Member or officers with significant roles in internal control, or where the fraud resulted in a material misstatement in the financial statements.
Significant difficulties	No significant difficulties were encountered during the audit.
Modifications to auditor's report	There are no modifications to our audit report.
Disagreements with management or scope limitations	The engagement team had no disagreements with management and no scope limitations were imposed by management during the audit.
Other information	No material inconsistencies were identified related to other information in the Narrative Report or Annual Governance Statement. These reports were found to be fair, balanced and comprehensive, and compliant with applicable requirements.
Our declaration of independence and any breaches of independence	No matters to report. The engagement team and others in the firm have complied with relevant ethical requirements regarding independence. See Appendix 6 for further details.
Accounting practices	Over the course of our audit, we have evaluated the appropriateness of the Authority's accounting policies, accounting estimates and financial statement disclosures. In general, we believe these are appropriate. We have set out our view of the assumptions used in valuing pension assets and liabilities and other accounting assumptions at page 12..
Significant matters discussed or subject to correspondence with management	There were no significant matters arising from the audit which were discussed, or subject to correspondence, with management

Appendix 5:

Required communications with the Audit Committee and the Council

There are a number of other communications required for EU PIEs. These are set out in the table below.

Required Communication	Commentary
Key audit partner(s)	We identified each key audit partner at Appendix 2 in our *External Audit Plan 2017-18* presented to you in May 2018.
Independence of external experts engaged by KPMG and non-KPMG auditors	We have not engaged non-KPMG auditors for the performance of any aspects of our audit.
Communications with audit committee and management	We have described the nature, frequency and extent of communication with the audit committee and management at Appendix 1 in our *External Audit Plan 2017-18* presented to you in May 2018.
Scope and timing of the audit	We have described the scope and timing of the audit at Appendix 1 in our *External Audit Plan 2017-18* presented to you in May 2018.
Audit methodology	Our audit methodology is described throughout this report.
Valuation methods	On page 12, we report the valuation methods applied to the items in the financial statements and the impact of any changes.
Going concern assessment	There are no significant matters affecting the entity's ability to continue as a going concern.
Requested explanations and documents	No matters to report. All requested explanations and documents were provided by management.
Materiality	Quantitative materiality applied to the audit of the financial statements as a whole and materiality for balances/disclosures affected by qualitative factors is set out at page 12 in our *External Audit Plan 2017-18* presented to you in May 2018. See also Appendix 4 of this report.
Non-compliance with laws and regulation or articles of association	No actual or suspected non-compliance with laws and regulation or articles of association were identified during the audit

Declaration of independence

ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF CITY OF LINCOLN COUNCIL

Professional ethical standards require us to provide to you at the conclusion of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed.

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code of Audit Practice, the provisions of Public Sector Audit Appointments Limited's ('PSAA's') Terms of Appointment relating to independence, the requirements of the FRC Ethical Standard and the requirements of Auditor Guidance Note 1 - General Guidance Supporting Local Audit (AGN01) issued by the National Audit Office ('NAO') on behalf of the Comptroller and Auditor General.

This Statement is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

— General procedures to safeguard independence and objectivity;

— Independence and objectivity considerations relating to the provision of non-audit services; and

— Independence and objectivity considerations relating to other matters.

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 partners, Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. As a result we have underlying safeguards in place to maintain independence through:

— Instilling professional values

— Communications

— Internal accountability

— Risk management

— Independent reviews.

The conclusion of the audit engagement leader as to our compliance with the FRC Ethical Standard in relation to this audit engagement and that the safeguards we have applied are appropriate and adequate is subject to review by an engagement quality control reviewer, who is a partner not otherwise involved in your affairs.

We are satisfied that our general procedures support our independence and objectivity.

Appendix 6:

Declaration of independence (cont.)

Independence and objectivity considerations relating to the provision of non-audit services

Summary of fees

We have considered the fees charged by us to the authority for professional services provided by us during the reporting period. We have detailed the fees charged by us to the authority and its controlled entities for significant professional services provided by us during the reporting period in Appendix 7, as well as the amounts of any future services which have been contracted or where a written proposal has been submitted. Total fees charged by us for the period ended 31 March 2018 can be analysed as follows:

	2017-18 £	2016-17 £
Audit of the Authority	47,185	50,056
Total audit services	**47,185**	**50,056**
Audit related assurance services	3,000	3,000
Mandatory assurance services	10,570	10,173
Total Non Audit Services	**13,570**	**13,173**

We are required by AGN 01 to limit the proportion of fees charged for non-audit services (excluding mandatory assurance services) to 70% of the total fee for all audit work carried out in respect of the Authority under the Code of Audit Practice for the year. The non-audit fees were 22.3% of the total fee for all audit work. We do not consider that the total of non-audit fees creates a self-interest threat since the absolute level of fees is not significant to our firm as a whole.

Facts and matters related to the provision of non-audit services and the safeguards put in place that bear upon our independence and objectivity, are set out in the table below..

Description of scope of services	Principal threats to independence and Safeguards applied	Basis of fee	Value of services delivered in the year ended 31 March 2018 £	Value of services committed but not yet delivered £
Audit-related assurance services				
Grant Certification – Pooling of Housing Capital Receipts Return	The nature of these audit-related services is to provide independent assurance on each of these returns. As such we do not consider them to create any independence threats.	Fixed Fee	3,000	nil
Mandatory assurance services				
Grant Certification – Housing Benefit Subsidy Return	The nature of this mandatory assurance service is to provide independent assurance on each of the returns. As such we do not consider it to create any independence threats.	Fixed Fee	10,570	Nil

Declaration of independence (cont.)

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the Audit Committee and the Council.

Confirmation of audit independence

We confirm that as of the date of this report, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the Audit Committee of the authority and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

Andrew Bush, Director

KPMG LLP

Appendix 7:

Audit fees

As communicated to you in our *Audit Fee Letter 2017-18*, our scale fee for the audit is £47,185 plus VAT. The PSAA scale fee for 2016/17 was £47,185, and additional fees of £2,871 were charged to cover the further work required as part of the accounts opinion and VFM conclusion.

As explained in our *External Audit Plan 2017/18* additional audit procedures have been required since the Authority has been identified as an EU PIE and we expect to submit fee variation requests to PSAA to cover this work. Any additional audit fees need to be agreed with the Authority's S.151 Officer before the variation request is submitted to PSAA.

Our work on the certification of the Authority's Housing Benefit Subsidy return and the Pooling Housing Capital Receipts Return is in progress and is expected to be completed by the 30 November 2018 deadline..

Component of the audit	2017-18 Planned Fee £	2016-17 Actual Fee £
Accounts opinion and value for money work		
PSAA Scale fee ([City of Lincoln Council])	47,185	50,056
Total audit services	**47,185**	**50,056**
Mandatory assurance services		
Housing Benefits Certification	10,570	10,173
Total mandatory assurance services	**10,570**	**10,173**
Audit-related assurance services		
Pooling of Housing Capital Receipts	3,000	3,000
Total audit-related assurance services	**3,000**	**3,000**
Total non-audit services	**13,570**	**13,173**
Grand total fees for the Authority	**60,755**	**63,229**

All fees quoted are exclusive of VAT.

The key contacts in relation to our audit are:

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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. We draw your attention to the Statement of Responsibilities of auditors and audited bodies, which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

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

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Andrew Bush, the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers, by email to Andrew.Sayers@kpmg.co.uk. After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

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