Annual Audit Letter

City of Lincoln Council

Year ending 31 March 2019

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1. EXECUTIVE SUMMARY

Purpose of the Annual Audit Letter

Our Annual Audit Letter summarises the work we have undertaken as the auditor for City of Lincoln Council (the Council) for the year ended 31 March 2019. Although this letter is addressed to the Council, it is designed to be read by a wider audience including members of the public and other external stakeholders.

Our responsibilities are defined by the Local Audit and Accountability Act 2014 (the 2014 Act) and the Code of Audit Practice issued by the National Audit Office (the NAO). The detailed sections of this letter provide details on those responsibilities, the work we have done to discharge them, and the key findings arising from our work. These are summarised below.

Area of responsibility	Summary
Audit of the financial statements	Our auditor's report issued on 3 October 2019 included our opinion that the financial statements: • give a true and fair view of the Council's financial position as at 31 March 2019 and of its expenditure and income for the year then ended; and • have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19
Other information published alongside the audited financial statements	Our auditor's report issued on 3 October 2019 included our opinion that: • The other information in the Statement of Accounts is consistent with the audited financial statements.
Value for Money conclusion	Our auditor's report concluded that we are satisfied that in all significant respects, the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.
Reporting to the group auditor	In line with group audit instructions issued by the NAO, on 3 October 2019 we reported to the group auditor in line with the requirements applicable to the Council's WGA return.
Statutory reporting	Our auditor's report confirmed that we did not use our powers under s24 of the 2014 Act to issue a report in the public interest or to make written recommendations to the Council.

2. AUDIT OF THE FINANCIAL STATEMENTS

Opinion on the financial statements	**Unqualified**

The scope of our audit and the results of our work

The purpose of our audit is to provide reasonable assurance to users that the financial statements are free from material error. We do this by expressing an opinion on whether the statements are prepared, in all material respects, in line with the financial reporting framework applicable to the Council and whether they give a true and fair view of the Council's financial position as at 31 March 2019 and of its financial performance for the year then ended.

Our audit was conducted in accordance with the requirements of the Code of Audit Practice issued by the NAO, and International Standards on Auditing (ISAs). These require us to consider whether:

- the accounting policies are appropriate to the Council's circumstances and have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management in the preparation of the financial statements are reasonable; and
- the overall presentation of the financial statements provides a true and fair view.

Our auditor's report, issued to the Council on 3 October 2019, stated that, in our view, the financial statements give a true and fair view of the Council's financial position as at 31 March 2019 and of its financial performance for the year then ended.

Our approach to materiality

We apply the concept of materiality when planning and performing our audit, and when evaluating the effect of misstatements identified as part of our work. We consider the concept of materiality at numerous stages throughout the audit process, in particular when determining the nature, timing and extent of our audit procedures, and when evaluating the effect of uncorrected misstatements. An item is considered material if its misstatement or omission could reasonably be expected to influence the economic decisions of users of the financial statements.

Judgements about materiality are made in the light of surrounding circumstances and are affected by both qualitative and quantitative factors. As a result we have set materiality for the financial statements as a whole (financial statement materiality) and a lower level of materiality for specific items of account (specific materiality) due to the nature of these items or because they attract public interest. We also set a threshold for reporting identified misstatements to the Audit Committee. We call this our trivial threshold.

The table below provides details of the materiality levels applied in the audit of the financial statements for the year ended 31 March 2019:

Financial statement materiality	Our financial statement materiality is based on 1.5% of Gross Revenue Expenditure at a Surplus/Deficit on Provision if Services level.	£1,757,000
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	£53,000
Specific materiality	We have applied a lower level of materiality to the following areas of the accounts:	
	- Officer's Emoluments	£110,000
	- Officer's Remuneration Bandings	£5,000 per individual officer
	- Members Allowances	£58,000
	- Audit Fee	£14,000

Our response to significant risks

As part of our continuous planning procedures we considered whether there were risks of material misstatement in the Council's financial statements that required special audit consideration. We reported significant risks identified at the planning stage to the Audit Committee within our Audit Strategy Memorandum and provided details of how we responded to those risks in our Audit Completion Report. The table below outlines the identified significant risks, the work we carried out on those risks and our conclusions.

Identified significant risk	Our response	Our findings and conclusions
Valuation of property, plant and equipment, investment properties and assets held for sale The financial statements contain material entries on the balance sheet as well as material disclosure notes in relation to the Council's holding of property, plant and equipment (PPE), investment properties and assets held for sale. The Council employs valuation experts to provide information on valuations, because there is a high degree of estimation uncertainty associated with the (re)valuations of PPE, investment properties and assets held for sale due to the significant judgements and number of variables involved.	We have: • critically assessed the Council's arrangements for ensuring that PPE, investment property and assets held for sale valuations are reasonable; • critically assessed the data provided by Gerald Eve (an expert commissioned by the NAO), as part of our challenge of the reasonableness of the valuations provided by the Council's valuers; • consider the competence, skills and experience of the valuers and the instructions issued to the valuers; and • where necessary, perform further audit procedures on individual assets to ensure the basis of valuations is appropriate.	Aside from a non-material classification error, there are no significant matters arising from our testing, and we have concluded that the Council's property, plant and equipment, investment properties and assets held for sale are materially fairly stated.
Valuation of net defined benefit liability The financial statements contain material accounting entries in respect of retirement benefits. The calculation of these pension figures, both assets and liabilities, can be subject to significant volatility and includes estimates based upon a complex interaction of actuarial assumptions. This results in an increased risk of material misstatement.	We have: • critically evaluated the Council's arrangements (including relevant controls) for making estimates in relation to pension entries within the financial statements; and • challenged the reasonableness of the Actuary's assumptions that underpin the relevant entries made in your financial statements, through the use of an expert commissioned by the National Audit Office.	We identified one non-material audit difference relating to the valuation of the liability as a result of two legal cases that impact on the Local Government Pension Scheme. Our overall conclusion was that the Council's Defined Benefit Pension Liability was materially fairly stated.

2. AUDIT OF THE FINANCIAL STATEMENTS (CONTINUED)

Identified significant risk	Our response	Our findings and conclusions
Management override of controls In all entities, management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits	We addressed this risk through performing audit work over: • accounting estimates impacting on amounts included in the financial statements; • consideration of identified significant transactions outside the normal course of business; and • journals recorded in the general ledger and other adjustments made in preparation of the financial statements.	There are no significant matters arising from our work on the management override of controls.
Revenue recognition Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition although, based on the circumstances of each audit, this is rebuttable. Having considered the factors for revenue recognition and the Council's revenue streams, we have concluded that the risk lies in the year-end balance sheet and in particular the existence and accuracy of debtors, specifically those that relate to useable reserves, are material, subject to manual intervention and/or significant estimation. This does not imply that we suspect actual or intended manipulation but that we continue to deliver our audit work with appropriate professional scepticism.	We addressed this risk through performing audit work over: • evaluating the design and implementation of controls to mitigate the risk of material manual debtors being recognised in the wrong period; • testing material manual debtors to ensure that they are supported by sufficient and appropriate evidence and have been accounted for correctly; • testing from receipts pre and post year-end to ensure revenue has been posted to the correct period; and • testing material year end journals.	There are no significant matters arising from our work on revenue recognition.

2. AUDIT OF THE FINANCIAL STATEMENTS (CONTINUED)

Identified significant risk	Our response	Our findings and conclusions
Expenditure recognition Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council (FRC), which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition. Again, based on the circumstances of each audit, this is rebuttable. Having considered the factors for expenditure recognition, we have concluded that the risk lies in the year end balance sheet and in particular the completeness and valuation of creditors, specifically those that are material, manually accrued and impact the Council's useable reserves. This does not imply that we suspect actual or intended manipulation but that we continue to deliver our audit work with appropriate professional scepticism.	We addressed this risk through performing audit work over: • evaluating the design and implementation of controls to mitigate the risk of material manual accruals being recognised in the wrong period; • testing material manual accruals to ensure that they are supported by sufficient and appropriate evidence and have been accounted for correctly; • testing of payments around the year-end to provide assurance that there are no material unrecorded items of income and expenditure in the 2018/19 accounts; and • testing material year end journals.	There are no significant matters arising from our work on expenditure recognition.

Internal control recommendations

As part of our audit we considered the internal controls in place that are relevant to the preparation of the financial statements. We did this to design audit procedures that allow us to express our opinion on the financial statements, but this did not extend to us expressing an opinion on the effectiveness of internal controls. We identified the following deficiencies in internal control as part of our audit.

Description of deficiency	Production of draft accounts and working papers The Council's finance team experienced turnover in several key posts during 2018/19. This resulted in a loss of detailed knowledge over particular aspects of the accounts production and ledger processes leading to increased pressure on staff time during the busy year-end period. Although the team managed to prepare a complete set of draft financial statements by the statutory deadline, which were received on 31 May 2019, these were of a standard that fell below our expectations. Given the pressures on staff the working papers provided in support of the financial statements were also found to be variable in quality and in some instances fell below the standard we would expect to see.
Potential effects	The presentation of imbalanced accounts and poor quality working papers can lead to inefficiencies for both the Council and auditors, as staff time is required to investigate, discuss and resolve issues and may, in certain circumstances, lead to delays in the audit timescales.
Recommendation	It is important that the Council takes the steps necessary to re-establish robust arrangements and staffing to support the 2019/20 year-end. Quality control procedures in respect of the accounts preparation process need to be strengthened and the Council, in its closedown procedures for 2019/20, should include sufficient time for a robust quality control process to be implemented.
Management response	Whilst it is acknowledged that improvements can be made for the future, the accounts were prepared using the same format and guidance as in previous years, which were deemed to be of an appropriate standard. All notes to the accounts and working papers will be reviewed for the forthcoming year end and time for quality checking will be built into the closedown timetable. It should be noted that all key positions are now filled.

2. AUDIT OF THE FINANCIAL STATEMENTS (CONTINUED)

Description of deficiency	Incomplete Disclosures for Pension Fund Plan Assets The Council relies on its actuary to provide it with the information necessary to meet CIPFA's Code of Practice disclosure requirements, including the accurate split of its pension fund plan assets into various classifications. Our audit has identified that the information provided by the actuary for this note is inaccurate and does not provide a full analysis for the Council to produce its accounts note accurately.
Potential effects	The Council's accounts may be materially misstated in respect of its disclosure requirements.
Recommendation	As part of its commissioning of actuarial services for future years the Council needs to ensure that it receives the information required for it to complete of the disclosure requirements completely and accurately.
Management response	In 2019/20 appropriate instructions will be given to the actuary to ensure that detailed information is provided on the split of fund assets to be included in the report provided.

Description of deficiency	Investment Property Valuations The Council is required to measure its investment properties at their fair value at the end of each reporting period. This fair value must reflect market conditions at the end of the reporting period and thus annual revaluations will be necessary unless the Council can demonstrate that the carrying value is not materially different from the fair value at that date. Our testing has identified that the Council employs a rolling 5 year programme of valuations as at 1 April each year for its investment properties, supported by a material change review as at 31 March. This has resulted in 35 investment properties not being subject to a formal revaluation during the course of the year, and represents a departure from the stated accounting policy in respect of these assets.
Potential effects	The Council may not be able to demonstrate that its investment property valuations are in accordance with the requirements of CIPFA's Code of Practice.
Recommendation	The Council should ensure that all of its investment properties are subject to annual revaluation, ideally as at 31 March, to ensure that their fair values can be accurately determined at the end of each reporting period.
Management response	Instructions will be given to the valuer to ensure that all investment properties are valued on an annual basis going forward and a revised valuation date will be agreed with the valuer.

3. VALUE FOR MONEY CONCLUSION

Value for Money conclusion	Unqualified

Our approach to Value for Money

We are required to consider whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The NAO issues guidance to auditors that underpins the work we are required to carry out in order to form our conclusion, and sets out the criterion and sub-criteria that we are required to consider.

The overall criterion is that, 'in all significant respects, the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.' To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria are set out by the NAO:

- Informed decision making;
- Sustainable resource deployment; and
- Working with partners and other third parties.

The NAO's guidance requires us to carry out work to identify whether or not a risk to the Value for Money conclusion exists. Risk, in the context of our Value for Money work, is the risk that we come to an incorrect conclusion rather than the risk of the arrangements in place at the Council being inadequate.

In our Audit Completion Report, we reported that we had identified no significant Value for Money risks and our auditor's report, issued to the Council on 3 October 2019 concluded that, in all significant respects, the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.

4. OTHER REPORTING RESPONSIBILITIES

Exercise of statutory reporting powers	**No matters to report**
Completion of group audit reporting requirements	**Below testing threshold**
Other information published alongside the audited financial statements	**Consistent**

The NAO's Code of Audit Practice and the 2014 Act place wider reporting responsibilities on us, as the Council's external auditor. We set out below, the context of these reporting responsibilities and our findings for each.

Matters on which we report by exception

The 2014 Act provides us with specific powers where matters come to our attention that, in our judgement, require reporting action to be taken. We have the power to:

- issue a report in the public interest;
- make statutory recommendations that must be considered and responded to publicly;
- apply to the court for a declaration that an item of account is contrary to law; and
- issue an advisory notice under schedule 8 of the 2014 Act.

We have not exercised any of these statutory reporting powers.

The 2014 Act also gives rights to local electors and other parties, such as the right to ask questions of the auditor and the right to make an objection to an item of account. We did not receive any such objections or questions.

Reporting to the NAO in respect of Whole of Government Accounts consolidation data

The NAO, as group auditor, requires us to complete the WGA Assurance Statement in respect of its consolidation data. We submitted this information to the NAO on 3 October 2019.

Other information published alongside the financial statements

The Code of Audit Practice requires us to consider whether information published alongside the financial statements is consistent with those statements and our knowledge and understanding of the Council. In our opinion, the other information in the Statement of Accounts is consistent with the audited financial statements.

5. OUR FEES

Fees for work as the Council's auditor

We reported our proposed fees for the delivery of our work in the Audit Strategy Memorandum, presented to Audit Committee in March 2019.

We have completed our work for the 2018/19 financial year, but at the time of producing this report, we have not yet finalised our audit fees for the year. During 2018/19 we carried out additional audit work, resulting in proposed additional fees, in the following areas:

- Extended auditor reporting and review requirements as a result of the Council being designated as an EU Public Interest Entity - £5,000;
- Review of actuarial impact on defined benefit pension liability arising from the GMP and McCloud legal cases - £750; and
- Discussion, review and testing of the Council's prior period adjustment - £1,000

Whilst these additional fees have been approved by the Chief Finance Officer the fee variation also requires the approval of Public Sector Audit Appointments Limited, before it can be finalised.

For the 2018/19 financial year, we can confirm that our final fees are expected to be as follows:

Area of work	2018/19 proposed fee	2018/19 final fee
Delivery of audit work under the NAO Code of Audit Practice	£36,332	£43,082
Certification of Housing Benefit Subsidy Claim	£6,600	£6,600

Fees for other work

Our assurance work on the Housing Benefit Subsidy Claim is a permitted service.

We undertook one non-audit engagement for the Council in the year relating to the Ministry of Housing Communities and Local Government's requirement for agreed upon procedures to be undertaken on the Council's 2017-2018 Pooling of Housing Capital Receipts return. Our fees for this work were £3,500.

6. FORWARD LOOK

Audit Developments

Code of Audit Practice

The Code of Audit Practice sets out what local auditors of relevant local public bodies are required to do to fulfil their statutory responsibilities under the Local Audit and Accountability Act 2014. We have responded to the National Audit Office's consultation on the content of the Code (https://www.nao.org.uk/code-audit-practice/about-code/).

A new Code will be laid in Parliament in time for it to come in to force no later than 1 April 2020.

Financial Resilience

2019 Spending Round

The Chancellor has announced a funding package of more than £3.5 billion for vital council services and this is the biggest year on year real terms increase in spending power for local government in a decade. This has provided councils with much of the funding certainty and stability needed for 2019/20 and will need to be incorporated into the Council's Medium Term Financial Planning processes.

Whilst the Council recognises that one of the key issues is the management of general reserves to a level that ensures it remains financially resilient and able to deliver sustainable services, it must ensure that it clarifies and quantifies how it will bridge any funding gap through planned expenditure reductions and/ or income generation schemes.

Local Authority Financial Resilience Index

CIPFA is moving forward with its financial resilience index, which it believes will be a barometer on which local authorities will be judged. We would expect the Council to have at least considered the index once it is formally released.

Commercialisation

The National Audit Office will be publishing a report on Commercialisation during 2019. Depending on the Council's appetite for Commercialisation, we would expect the Council to consider the outcome of the report and ensure any lessons learnt are incorporated into business practice.

Further, the UK Debt Management Office's Annual Report, published on 23 July 2019, reported that, as at 31 March 2019, the Public Works Loan Board's loan book was £78.3 billion with 1,308 new loans totalling £9.1 billion advanced during the year. As a result, we expect local authorities to clearly demonstrate:

- the value for money in the use of Public Works Loan Board funds to acquire commercial property; and
- the prudency of its arrangements for loan repayment through applying the updated Statutory Guidance on Minimum Revenue Provision in 2019/20, 2020/21 and beyond.

Financial Reporting

UK Local Government Annual Accounts

The CIPFA/LASAAC Local Authority Code Board specifies the financial reporting requirements for UK local government. A consultation is underway to inform the direction and strategy for local government annual accounts. We will be submitting our response and suggest practitioners also voice their opinion.

Lease accounting

The implementation of IFRS 16 Leases in the Code is delayed until 1 April 2020. The Council will need a project plan to ensure the data analysis and evaluation of accounting entries is completed in good time to ensure any changes in both business practice and financial reporting are captured.

6. FORWARD LOOK (CONTINUED)

Next year's audit and how we will work with the Council

We will focus our work on the risks that your challenges present to your financial statements and your ability to maintain proper arrangements for securing value for money.

In the coming year we will continue to support the Council by:

- continued liaison with the Council's Internal Auditors to minimise duplication of work;
- attending Audit Committee meetings and presenting an Audit Progress Report including updates on regional and national developments; and
- hosting events for staff, such as our Local Government Accounts workshop.

We will meet with the Council to identify any learning from the 2018/19 audit and will continue to share our insights from across local government and relevant knowledge from the wider public and private sector.

In terms of the technical challenges that officers face around the production of the statement of accounts, we will continue to work with them to share our knowledge of new accounting developments and we will be on hand to discuss any issues as and when they arise.

The Council has taken a positive and constructive approach to our audit and we wish to thank Members and officers for their support and co-operation during our audit.

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