Annual Audit Letter

City of Lincoln Council

Year ending 31 March 2020

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Contents

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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 2020. 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 31 March 2021 included our opinion that the financial statements: • give a true and fair view of the Council's financial position as at 31 March 2020 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 2019/20
Other information published alongside the audited financial statements	Our auditor's report 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 2020.
Reporting to the group auditor	In line with group audit instructions, issued by the NAO on 4th November, we reported to the group auditor in line with the requirements applicable to the Council's Whole of Government Accounts 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. The report also confirmed that we did not exercise any other special powers of the auditor under sections 28, 29 or 31 of the 2014 Act.

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 2020 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, stated that in our view, the financial statements give a true and fair view of the Council's financial position as at 31 March 2020 and of its financial performance for the year then ended.

Our auditor's report was modified to include an emphasis of matter paragraph. This drew attention to the financial statement disclosure explaining that Covid-19 had contributed to 'material valuation uncertainty' in the valuation of the Council's property, plant and equipment, investment properties, assets held for sale and in the Council's share of Lincolnshire Pension Fund's property investment assets included in the estimated net Pension Liability.

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 2020:

Financial statement materiality	Our financial statement materiality is based on circa. 1.5% of gross operating expenditure.	£1,642k
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	£49k
Specific materiality	We have applied a lower level of materiality to the following areas of the accounts:	
	- Termination payments	£13k
	- Senior Officer Remuneration	£5k
	- Members Allowances	£61k
	- External Audit Fee	£9k

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
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. Because of 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. • Journals recorded in the general ledger and other adjustments made in preparation of the financial statements.	Our audit procedures did not identify any material errors or uncertainties in the financial statements, or other matters that we wish to highlight.

2. AUDIT OF THE FINANCIAL STATEMENTS

Identified significant risk	Our response	Our findings and conclusions
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 this can be rebutted with the exception of fees and charges. In this respect, we believe the risk is focused on the year-end position and in particular the cut-off of revenue. 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.	Our audit procedures did not identify any material errors or uncertainties in the financial statements, or other matters that we wish to highlight.

Our response to significant audit risks (continued)

Identified significant risk	Our response	Our findings and conclusions
Valuation of Property, Plant and Equipment, Investment Properties and Assets Held For Sale The CIPFA Code requires that where assets are subject to revaluation, their year-end carrying value should reflect the fair value at that date. The Council has adopted a rolling revaluation model which sees all land and buildings revalued in a five-year cycle, with investment properties and assets held for sale being revalued annually. The valuation of these assets involves the use of two management experts (the valuers) and incorporates assumptions and estimates which impact materially on the reported values. There are audit risks relating to the valuation process. As a result of the rolling programme of revaluations, there is a risk that individual assets which have not been revalued for up to four years are not valued at their materially correct fair value. In addition, as some of the valuations are undertaken at the start of the year, there is a risk that the fair value of the assets may be materially different at the year end. Council dwelling valuations are based on Existing Use Value, discounted by a factor to reflect that the assets are used for Social Housing (EUV-SH). The Social Housing adjustment factor is prescribed in MHCLG guidance, but this guidance indicates that where a valuer has evidence that this factor is different in the Council's area they can use their more accurate local factor. There is a risk that the Council's application of the valuer's assumptions is not in line with the statutory requirements and that the valuation is not supported by detailed evidence.	We addressed this risk through performing audit work over: • Obtaining an understanding of the skills, experience and qualifications of the valuers, and consideration of the appropriateness of the instructions to the valuers from the Council; • Obtaining an understanding of the basis of valuation applied by the valuers in the year; • Obtaining an understanding of the Council's approach to ensure that assets not subject to revaluation in 2019/20 are materially fairly stated; • Obtaining an understanding of the Council's approach to ensure that assets revalued through 2019/20 are materially fairly stated at the year end; • Sample testing the completeness and accuracy of underlying data provided by the Council and used by the valuers as part of their valuations; • Using relevant market and cost data to assess the reasonableness of the valuation as at 31 March 2020; • Obtaining an understanding of the valuers' consideration of RICS guidance on material uncertainty relating to valuations, and considered whether there was evidence of material uncertainty; and • Testing the accuracy of how valuation movements were presented and disclosed in the financial statements.	We obtained sufficient appropriate evidence to conclude that the valuation of property, plant and equipment, investment properties and assets held for sale included in the financial statements was reasonable. We drew attention to Note 4 of the financial statements, which disclosed a material valuation uncertainty relating to the valuation of the Council's property, plant and equipment, investment properties and assets held for sale. We included reference to this disclosure in our audit report but highlighted that our audit opinion was not modified in respect of this matter.

Our response to significant audit risks (continued)

Identified significant risk	Our response	Our findings and conclusions
Valuation of the Net Pension Liability The net pension liability represents a material element of the Council's balance sheet. The Council is an admitted body of the Lincolnshire Pension Fund, which had its last triennial valuation completed as at 31 March 2019. 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 Council's overall valuation. There are financial assumptions and demographic assumptions used in the calculation of the Council's valuation, such as the discount rate, inflation rates and mortality rates. The assumptions should also reflect the profile of the Council'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 valuing the Council's pension obligation are not reasonable or appropriate to the Council's circumstances. This could have a material impact to the net pension liability in 2019/20. In addition our work considered two issues that emerged through 2020. In July 2020, MHCLG consulted on the proposed remedy for the 'McCloud' case, an estimate of which was originally included in the Council's liability in 2018/19. The proposed remedy indicates that the actuarial estimate of the original liability made in 2018/19 was likely to be overstating the pension fund liability but not materially. A second emerging issue this year is the 'Goodwin' case which also relates to groups of pension fund members suffering discrimination. In both issues, we engaged with the Council's actuary and reviewed the evidence provided by the pension fund and the Council's actuary in order to conclude on the material accuracy of the liability.	We addressed this risk through performing audit work over: • Obtaining an understanding of the skills, experience and qualifications of the actuary, and considering the appropriateness of the instructions to the actuary from the Council; • Obtaining confirmation from the auditor of the Lincolnshire Pension Fund that the controls in place at the Pension Fund were operating effectively. This included the controls in place to ensure data provided to the actuary by the Pension Fund for the purposes of the IAS19 valuation of the gross asset and liability is complete and accurate; • Reviewing a summary of the work performed by the Pension Fund auditor on the Pension Fund investment assets, and evaluating whether the outcome of their work would affect our consideration of the Council's share of Pension Fund assets. The Pension Fund auditor's work included comparing the asset values used for the actuarial valuation to those subjected to audit by the Pension Fund auditor; • Reviewing the actuarial allocation of Pension Fund assets to the Council by the actuary, including comparing the Council's share of the assets to other corroborative information; • Reviewing the appropriateness of the Pension Asset and Liability valuation methodology applied by the actuary, and the key assumptions included within the valuation. This included comparing it to expected ranges, utilising information provided by PwC LLP, consulting actuary engaged by the National Audit Office; and • Agreeing the data in the IAS 19 valuation report provided by the actuary for accounting purposes to the pension accounting entries and disclosures in the financial statements and considered the implications of the revised IAS 19 valuation report on the Council's disclosures.	We obtained sufficient appropriate evidence to conclude that the valuation of the net defined benefit pension liability included in the financial statements was reasonable. Whilst a revised actuarial report was obtained to incorporate the estimate of the proposed 'McCloud' and 'Goodwin' remedies its impact on the financial statements was judged by the Council to be not material. Consequently the financial statements were not amended to reflect this updated estimate. We drew attention to Note 4 of the financial statements, which disclosed the material uncertainty, disclosed in the Lincolnshire Pension Fund accounts, relating to the valuation of the Pension Fund property investment assets. The valuation of the Council's share of the Pension Fund property investment assets as disclosed in Note 44 was £11.48m. We included reference to this disclosure in our audit report but highlighted that our audit opinion was not modified in respect of this matter.

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	Expected Credit Loss Model Our review of the Council's debt impairment calculations have confirmed that these are not in accordance with its stated accounting policy which establishes the use of the expected credit loss model as required under IFRS 9 and the CIPFA Code.
Potential effects	The Council is not fully complying with the requirements of current accounting standards and the CIPFA Code. This may lead to the incorrect debt impairment figure being calculated and disclosed within the financial statements.
Recommendation	The Council should review its approach to the calculation of its debt impairment to ensure that this accords with the requirements of IFRS 9 and the CIPFA Code.
Management response	The Council will review IFRS 9 and the CIPFA Code and will amend the working papers to ensure compliance in the calculation of the debt impairment.

Description of deficiency	Continuing Access to Active Directory Following Termination of Employment Our review and testing of the Council's general IT arrangements identified a number of instances where leavers access rights on the Active Directory had not been removed promptly.
Potential effects	There is a risk of the Council's IT infrastructure assets being accessed inappropriately using the credentials of staff who have ceased employment with the Council.
Recommendation	The Council should review its approach for identifying and actioning the removal of Active Directory access following an employees termination of employment.
Management response	All managers have been reminded that they need to fill out the appropriate forms when members of the team leave the authority. IT are actioning any leavers notifications promptly.

2. AUDIT OF THE FINANCIAL STATEMENTS

Description of deficiency	Production of draft accounts and working papers Both staff turnover during the year and the consequential impacts of staff absences and re-deployments as a result of the Covid-19 pandemic, led to increased pressure on finance staff during the accounts production cycle, resulting in higher than expected levels of audit adjustments and impacting the quality of working papers.
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 2020/21 year-end. Quality control procedures in respect of the accounts preparation process need to be strengthened and the Council, in its closedown procedures for 2020/21, should include sufficient time for a robust quality control process to be implemented.
Management response	Completion of the SOA and audit for 2019/20 was undertaken at a time when there were significant resource pressures on the Financial Services due to the Covid19 pandemic and a need to support the Council in its response phase. Alongside this officers were remotely working which created some early issues for the team, which were eventually resolved. There were also a number of complexities to the SOA created by the pandemic which required additional work to be undertaken. During the completion of the SOA and audit two members left the team as part of natural turnover. Taking these factors into account it is a testament to the team that the accounts were produced in time for the statutory deadline. It is acknowledged that due to these issues the quality of the working papers was not to the high standard we would expect. The Financial Services team ae now fully staffed to support the 20/21 year end process and have ensured additional time is built into the closedown timetable for quality checking.

3. VALUE FOR MONEY CONCLUSION

Value for money conclusion	Unqualified

Our audit approach

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.

Significant audit risks

The NAO's guidance requires us to carry out work to identify whether or not a risk to our conclusion exists. Risk, in the context of our 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.

When we perform our work, we consider whether there are any areas requiring additional audit attention as a "Significant Audit Risk", which we report to the Audit Committee prior to finalising our conclusion. For 2019/20, we did not identify any significant audit risks.

Overall Conclusion

Our auditor's report stated that 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 2020.

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 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 National Audit Office, as group auditor, requires us to complete a Whole of Government Accounts Assurance Statement in respect of financial consolidation data produced by the Council. We submitted this information to the NAO on 30 March 2021.

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.

Having completed our work for the 2019/20 financial year, we can confirm that our final fees are as follows:

Area of work	2019/20 proposed fee	2019/20 final fee
Delivery of audit work under the NAO Code of Audit Practice	£36,332	£36,332
Fee Variations*:		
• Additional reporting requirements as a result of classification as a Public Interest Entity		£5,000
• Additional testing on Property, Plant & Equipment and Defined Benefit Pensions Schemes		£7,067
• Additional costs associated with 2019/20, including, but not limited to: • Impact of 'Material Valuation Uncertainty' on the Council's land and buildings and its share of Pension Fund property assets. • Updating audit risk assessments, including the value for money conclusion. • Additional considerations of estimation uncertainty in going concern. • Changes impacting pension liabilities through the McCloud and Goodwin legal cases.		£5,032
Final audit fee	**£36,332**	**£53,431**

** - Fee variations subject to confirmation from PSAA.*

Fees for other work

In addition to delivering audit work under the NAO's Code of Audit Practice, we have been engaged by the Council to carry out three pieces of assurance work as follows:

Area of work	2019/20 proposed fee	2019/20 final fee
Assurance:		
• Certification of Housing Benefit Subsidy Claim	£6,600	**
• Pooling of Housing Capital Receipts Return	£3,250	£3,250
• Homes England Grant Review	£3,500	£3,500

*** - Work is ongoing*

Changes to the Code of Audit Practice

The Code of Audit Practice (the Audit Code), issued by the Comptroller and Auditor General, prescribes the way we carry out our responsibilities as your auditors. On 1st April 2020 a new Code came in to force and will apply to our work from 2020/21 onwards.

The new Audit Code continues to apply the requirements of International Standards on Auditing (ISAs) to our audit of the financial statements. While there are changes to the ISAs that are effective from 2020/21 the Audit Code has not introduced any changes to the scope of our audit of the financial statements. We will continue to give our opinion on the financial statements in our independent auditor's report.

There are however significant changes to the work on value for money arrangements, and the way we report the outcomes of our work to you.

The auditor's work on value for money arrangements

From 2020/21 we are still required to satisfy ourselves that you have made proper arrangements for securing the economy, efficiency and effectiveness in your use of resources, however unlike under the 2015 Audit Code, we will no longer report in the form of a conclusion on arrangements. Instead, where our work identifies significant weaknesses in arrangements, we are required to report those weaknesses to you, along with the actions that need to be taken to address those weaknesses.

Our work will focus on three criteria specified in the revised Audit Code:

- Financial sustainability: how the body plans and managers its resources to ensure it can continue to deliver its services;
- Governance: how the body ensures that it makes informed decisions and properly manages its risks; and
- Improving economy, efficiency and effectiveness: how the body uses information about its costs and performance to improve the way it manages and delivers its services.

Under the new Audit Code, we will be expected to report and make recommendations as soon as we identify a significant weakness in arrangements, as opposed to reporting our conclusion on arrangements at the end of the audit cycle as has previously been the case.

Reporting the results of the auditor's work

We currently issue you with an Annual Audit Letter which provides a summary of our work across all aspects of our audit. From 2020/21 the Annual Audit Letter will be replaced by the Auditor's Annual Report. This will continue to provide a summary of our work over the year of audit but will also include a detailed commentary on your arrangements in place to achieve economy, efficiency and effectiveness. This commentary replaces the conclusion on arrangements that was previously provided and will include details of any significant weakness identified and reported to you, follow up of any previous recommendations made, and our view as to whether recommendations have been implemented satisfactorily.

The new Audit Code will result in additional officer time and auditor time and therefore audit fees.

6. FORWARD LOOK: AUDIT CHANGES 2020/21

Redmond Review

In September 2020, Sir Tony Redmond published the findings of his independent review into the oversight of local audit and the transparency of local authority financial reporting. The report makes several recommendations that, if implemented, could affect both the financial statements that local authorities are required to prepare and the work that we as auditors are required to do.

The report and recommendations are wide-ranging, and includes:

- the creation of the Office of Local Audit and Regulation (OLAR), to manage, oversee and regulate local audit;
- reviewing reporting deadlines;
- reviewing governance arrangements in local authorities, including the membership of the Audit Committee; and
- increasing transparency and reducing the complexity of local authority financial statements.

The recommendations and findings have been considered by the Ministry of Housing, Communities and Local Government and we look forward to working with all stakeholders to implement changes to ensure the development and sustainability of local audit.

The full report is available here: https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-independent-review

CONTACT

Mark Surridge

Director

Mobile: 07875 974291

Email: mark.surridge@mazars.co.uk

Jon Machej

Manager

Mobile: 07766 540252

Email: jon.machej@mazars.co.uk