KPMG

Report to those charged with governance (ISA 260) 2015/16

Police and Crime Commissioner for Lincolnshire and Chief Constable for Lincolnshire

July 2016

Contents

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This report is addressed to the PCC and CC and has been prepared for the sole use of the PCC and CC. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document 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 Cardoza, the engagement lead to the PCC and CC, 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 (on 020 7694 8981, or 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, Third Floor, Local Government House, Smith Square, London, SW1P 3HZ.

Section one: Introduction

Introduction

This document summarises:

- **The key issues identified during our audit of the financial statements for the year ended 31 March 2016 for both the PCC and the CC; and**
- **Our assessment of the PCC and CC's arrangements to secure value for money.**

Scope of this report

This report summarises the key findings arising from:

- Our audit work at the Police and Crime Commissioner for Lincolnshire ('the PCC') and the Chief Constable for Lincolnshire ('the CC') in relation to their 2015/16 financial statements; and
- The work to support our 2015/16 conclusion on the PCC and CC's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

Financial statements

Our External Audit Plan 2015/16, presented to you in March 2016, set out the four stages of our financial statements audit process.

Planning	Control Evaluation	Substantive Procedures	Completion

This report focuses on the third stage of the process: substantive procedures. Our on site work for this took place during June 2016.

We are now in the final phase of the audit, the completion stage. Some aspects of this stage are also discharged through this report.

VFM Conclusion

Our External Audit Plan 2015/16 explained our risk-based approach to VFM work. We have now completed the work to support our 2015/16 VFM conclusion. This included:

- Assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion;
- Considering the results of any relevant work by the PCC and CC and other inspectorates and review agencies in relation to these risk areas; and
- Carrying out additional risk-based work.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our audit work in relation to the 2015/16 financial statements of the PCC and CC.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1. We have also reviewed your progress in implementing prior recommendations and this is detailed in Appendix 2.

Acknowledgements

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

Section two: Headlines

Headlines

This table summarises the headline messages for the PCC and CC. Sections three and four of this report provide further details on each area.

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Proposed audit opinion	We anticipate issuing unqualified audit opinions on the PCC and CC's financial statements by 12 August 2016. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.
Audit adjustments	We identified a single material audit adjustment with a value of £4 million which has been adjusted. In addition to this we also identified a number of other significant adjustments to the financial statements, most of which were presentation and disclosure issues, although there were some adjustments above our reporting threshold that affected the classification of balances within the primary statements and these are detailed on page 9 and at Appendix 3. It is our understanding that these will be adjusted in the final version of the financial statements.
Key financial statements audit risks	We identified the following key financial statements audit risks in our External Audit Plan 2015/16 presented to you in March 2016. — Management override of controls; — Fraudulent revenue recognition; and — Assurance over regional collaboration accounts and transactions. We have worked with officers throughout the year to discuss these key risks and our detailed findings are reported in section 3 of this report. There are no matters of any significance arising as a result of our audit work in these key risk areas.

Headlines (cont.)

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

Accounts production and audit process	We have noted an improvement in the quality of the accounts and the supporting working papers, particularly in those relating to property, plant and equipment (PPE) and capital accounting/financing. Officers dealt efficiently with the majority of audit queries and the audit process has been completed within the planned timescales. The PCC is yet to implement one of the recommendations in our ISA 260 Report 2014/15 relating to the financial statements, although we have confirmed that plans are in place to do so in 2016/17.
Completion	At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas: — Receipt of assurance letters from regional collaboration lead Chief Finance Officers; — Receipt of satisfactory assurances from the Lincolnshire LGPS auditor; and — Whole of Government Accounts. Before we can issue our opinion we require a signed management representation letter. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the PCC and CC's financial statements.
VFM conclusion and risk areas	We identified the following VFM risk from our risk assessment work which we verbally reported to you at the Joint Independent Audit Committee in March 2016: — Financial resilience and delivery of medium term financial plan. We have worked with officers throughout the year to discuss this VFM risk and our detailed findings are reported in section 4 of this report. There are no matters of any significance arising as result of our audit work in this VFM risk area. We have concluded that the PCC and CC has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion by 12 August 2016.

Section three: Financial Statements

Proposed opinion and audit differences

We have identified a single issue in the course of the audit that is considered to be material.

We anticipate issuing an unqualified audit opinion in relation to the PCC and CC's financial statements by 12 August 2016.

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the PCC and CC's financial statements following approval of the Statement of Accounts by the PCC and CC.

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 5 for more information on materiality) level for this year's audit was set at £2 million. Audit differences below £100k are not considered significant.

Our audit identified a single material misstatement of £4m in relation to the misclassification of an investment balance as cash and cash equivalents within the Balance Sheet, in addition to a number of other significant audit differences, which we set out in Appendix 3.

The tables on the right illustrate the total impact of audit differences on the PCC Group's movements on the General Fund for the year and Balance Sheet as at 31 March 2016.

There is no net impact on the General Fund as a result of audit adjustments.

Movements on the General Fund 2015/16

£m	Pre-audit	Post-audit	*Ref (App.3)*
Deficit on the provision of services	(26.0)	(26.0)	3 & 4
Adjustments between accounting basis and funding basis under Regulations	27.5	27.5	
Net transfers (to) earmarked reserves	(1.7)	(1.7)	
(Decrease) in General Fund	**(0.2)**	**(0.2)**	

Balance sheet as at 31 March 2016

£m	Pre-audit	Post-audit	*Ref (App.3)*
Property, plant and equipment	30.7	30.7	2
Other long term assets	4.3	4.3	
Current assets	28.0	28.0	1
Current liabilities	(20.0)	(20.0)	
Long term liabilities	(1,162.1)	(1,162.1)	
Net worth	**(1,119.1)**	**(1,119.1)**	
General Fund	(5.7)	(5.7)	
Other usable reserves	(13.3)	(13.3)	
Unusable reserves	1,138.1	1,138.1	
Total reserves	**(1,119.1)**	**(1,119.1)**	

Proposed opinion and audit differences (cont.)

The wording of your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007 and revised in December 2012.

Of the other audit adjustments we have identified, the most significant in monetary value are as follows:

- Misclassification of property, plant and equipment balances within Note 12 resulting in £1m of adjustments; and
- Incorrect allocation of capital grants of £0.7m to the 'Cost of services' rather than 'Taxation and non-specific grant income'.

In addition, we identified a number of presentational adjustments required to ensure that the accounts are compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 ('the Code'), the most significant being:

- Failure to disclose the 'Amounts reported for resource allocation decisions' in accordance with the Code requirements;
- Misstatement of the carrying value of leased assets by £4.1m within the leasing note; and
- Misclassification of £1.2m of cash flow movements within the detailed cash flow notes.

Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

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

Significant risks and key areas of audit focus

We have worked with the PCC and CC throughout the year to discuss significant risks and key areas of audit focus.

This section sets out our detailed findings on those risks.

In our External Audit Plan 2015/16, presented to you in March 2016, we identified the significant risks affecting the PCC and CC's 2015/16 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

The table below sets out our detailed findings for each of the risks that are specific to the PCC and CC.

Significant audit risk	Issue	Findings
Regional collaboration	The level of collaborative work with other forces across the East Midlands has increased significantly over the past few years, with the previous accounts including some £2.8m of expenditure in relation to these arrangements. This level of collaboration brings with it the need to ensure that appropriate governance arrangements are in place for each arrangement and that the necessary assurances are held over the completeness and accuracy of the financial information being provided to the PCC and CC for consolidation into its accounts. This risk affects both the PCC and CC.	We have reviewed your arrangements to seek assurances over each aspect of regional collaboration, in particular those covering the completeness and accuracy of the year end figures consolidated into your financial statements. We found that the appropriate assurances had been received in respect of the governance arrangements of the regional collaboration, and that assurances had been requested from each lead body's Chief Finance Officer over the completeness and accuracy of financial transactions. At this point in time these assurances are still outstanding.

Significant risks and key areas of audit focus (cont.)

In our External Audit Plan 2015/16 we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. These risk areas were Management override of controls and the Fraud risk of revenue recognition.

The table below sets out the outcome of our audit procedures and assessment on these risk areas.

Areas of significant risk		Summary of findings
Management override of controls	Audit areas affected — All areas.	Our audit methodology incorporates the risk of management override as a default significant risk. 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. 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.
Fraud risk of revenue recognition	Audit areas affected — None.	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 2015/16 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.

Significant risks and key areas of audit focus (cont.)

In our External Audit Plan 2015/16, presented to you in March 2016, we identified two areas of audit focus. These are not considered as significant risks but areas of importance where we would carry out some substantive audit procedures to ensure there is no risk of material misstatement.

We have now completed our testing. The table sets out our detailed findings for each area of audit focus.

Areas of audit focus	Issue	Findings
Capital financing	In the previous year we identified issues in respect of the capital financing transactions in relation to the PCC's collaborative arrangements specifically around the calculation of the Minimum Revenue Provision. This risk affects only the PCC.	We have reviewed the detailed capital financing transactions for 2015/16 confirming their accuracy and specifically ensuring that the Minimum Revenue Provision has been calculated in accordance with the PCC's chosen methodology.
Split of pensions costs	In the previous year we agreed a methodology with the PCC/CC for splitting the net defined benefit liability across the two organisations. This methodology deferred the requirement to record the Income and Expenditure Account impact of these transactions on the grounds of immateriality with the proviso that they would be made from 2015/2016 onwards. This risk affects both the PCC and CC.	We have reviewed the PCC/CC's process in relation to the identification of the necessary Income & Expenditure Account transactions ensuring that they have been calculated accurately using a reasonable basis.

Accounts production and audit process

We have noted an improvement in the quality of the accounts and the supporting working papers.

Officers dealt efficiently with the majority of audit queries and the audit process could be completed within the planned timescales.

The PCC and CC have implemented the majority of the recommendations in our ISA 260 Report 2014/15.

Accounts production and audit process

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

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The PCC and CC has strengthened its financial reporting process by improving its review arrangements prior to the issue of the financial statements. We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 13 June 2016. The PCC and CC have made a number of minor amendments to the accounts presented for audit, however there have been no changes which affect the financial position.
Quality of supporting working papers	Our Accounts Audit Protocol, which we issued in February 2016 and discussed with the Reporting Manager and Deputy Chief Finance Officer, set out our working paper requirements for the audit. The quality of working papers provided showed an improvement since the previous year, particularly in those relating to property, plant and equipment (PPE) and capital accounting/financing, and met the standards specified in our Accounts Audit Protocol.
Response to audit queries	The response in resolving audit queries showed a significant improvement over the previous year, principally through the appointment of key liaison officer, with the majority of audit queries being resolved in a reasonable time.

Findings in respect of the control environment for key financial systems

There are no significant findings to report to you in respect of the control environment.

Prior year recommendations

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

The PCC and CC has implemented the majority of the recommendations in our ISA 260 Report 2014/15 and we have confirmed that plans are in place to implement the remaining recommendation in 2016/17.

Appendix 2 provides further details.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the PCC and CC's financial statements.

Before we can issue our opinion we require a signed management representation letter.

Once we have finalised our opinions and conclusions we will prepare our Annual Audit Letter and close our audit.

Declaration of independence and objectivity

As part of the finalisation process we are required to provide you with representations concerning our independence.

In relation to the audit of the financial statements of the Police and Crime Commissioner for Lincolnshire and the Chief Constable for Lincolnshire for the year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and the Police and Crime Commissioner for Lincolnshire and the Chief Constable for Lincolnshire, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

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

Management representations

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

As part of this process we are seeking specific management representations in respect of the assurances you have gained over the completeness and accuracy of the figures consolidated for the regional collaboration.

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.

Section four: Value for Money

VFM Conclusion

Our VFM conclusion considers whether the PCC and CC 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 follow a risk based approach to target audit effort on the areas of greatest audit risk.

We have concluded that in all significant respects the PCC and CC have proper arrangements to ensure they took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Background

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'.

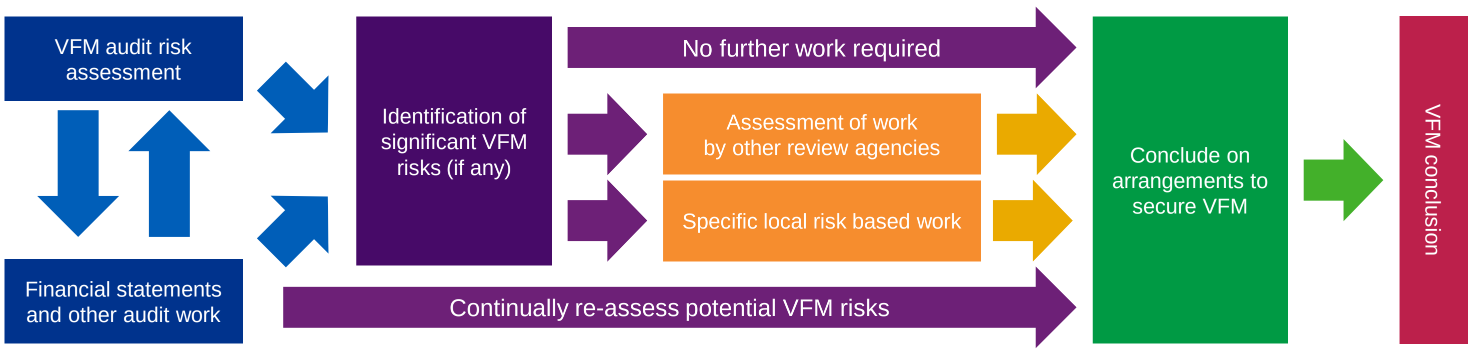
This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to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

The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria.

These sub-criteria provide a focus to our VFM work at the Authority.

Overview of the VFM audit approach

The key elements of the VFM audit approach are summarised below.



VFM Conclusion (cont.)

We have identified a single specific VFM risk.

Work completed

In line with the risk-based approach set out on the previous page, and in our External Audit Plan we have:

- Assessed the PCC and CC's key business risks which are relevant to our VFM conclusion;
- Identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;
- Considered the results of relevant work by the PCC and CC, inspectorates and review agencies in relation to these risk areas; and
- Completed specific local risk based work.

Key findings

Below we set out the findings in respect of those areas where we have identified a residual audit risk for our VFM conclusion.

We concluded that we needed to carry out additional work for these risks. This work is now complete and we also report on this below.

Section four

Specific VFM Risks

We are satisfied that external or internal scrutiny provides sufficient assurance that the PCC and CC's current arrangements in relation to this risk area is adequate.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Financial Resilience and Delivery of MTFS	Lincolnshire Police along with all forces have significant budget savings to deliver over the coming years and plans are in place to achieve these savings. The PCC needs to manage its savings plans to secure longer term financial and operational sustainability. This is relevant to the sustainable resource deployment sub-criteria of the VFM conclusion.	All police bodies have been affected by reductions in central funding and the PCC/CC has to date responded well to these pressures, with levels of service provision being maintained whilst demonstrating good performance in the identification and delivery of savings. Against this backdrop the PCC has continued to maintain a prudent level of general reserves. However, the PCC has constructed its Medium Term Financial Strategy on the key assumption of receiving additional central funding from the Home Office as part of its grant settlement from 2017/18 onwards. Since the options for further savings without operational impact are minimal, this is a relatively high risk strategy for achieving financial balance. **Specific risk based work required: Yes** We have assessed the arrangements put in place by the PCC and CC to maintain its record of meeting efficiency savings to address national funding changes, by relying on our accounts audit work where relevant, underpinned by a review of the PCC and CC's budget setting process, financial management processes, and discussions with the senior management team.

Appendices

Key issues and recommendations

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

The PCC and CC should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

Priority rating for recommendations					
❶	***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.	❷	***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.	❸	***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.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
1	❷	The PCC should ensure that component accounting is implemented fully in accordance with the requirements of the Code at the next full revaluation date.	The approach to component accounting will be reviewed in readiness for the preparation of the 2016/17 accounting statements. This will include a restatement of the threshold for including components within the asset register. The PCC has appointed a new valuer to undertake a full revaluation of property assets, this revaluation will include the asset components necessary to complete the component accounting requirements. . Responsible Officer: Reporting Manager Due Date: 30 September 2016

Appendix 2

Follow up of prior year recommendations

The PCC and CC has implemented the majority of the recommendations in our *ISA 260 Report 2014/15*.

We have confirmed that plans are in place to implement the outstanding recommendation in 2016/17.

This appendix summarises the progress made to implement the recommendations identified in our ISA 260 Report 2014/15 and re-iterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	4
Implemented in year or superseded	3
Remain outstanding (re-iterated in Appendix 1)	1

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at July 2016
1	1	The quality of the working papers in relation to capital accounting and capital financing were poor, with no detailed summary of asset movements and an over-reliance placed on system reports to substantiate figures. Improvements to the PCC's working papers are required.	Responsible Officer: Reporting Manager Due Date: 28 February 2016	Improvements have been made to the quality of working papers, particularly in those relating to property, plant and equipment (PPE) and capital accounting/financing, with those presented for the current year's audit being of an appropriate quality.
2	2	The PCC should ensure that component accounting is implemented fully in accordance with the requirements of the Code at the next full revaluation date.	Responsible Officer: Reporting Manager Due Date: 28 February 2016	Whilst not implemented for 2015/16 it is expected that accurate valuations and residual lives in respect of componentised property assets will be obtained at the next full revaluation, being 1 April 2016. This recommendation has therefore been carried forward.
3	2	The income and expenditure figures for pension costs should be split between the CC and PCC accounts for future years.	Responsible Officer: Reporting Manager Due Date: 28 February 2016	Income and expenditure figures in respect of pension costs have now been split between the respective accounts using a reasonable methodology.

Follow up of prior year recommendations (cont.)

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at July 2016
4	3	There is a difference of 71 between the number of pensioners in the actuary's report and the payroll headcount. Whilst this is unlikely to impact on the accounts, the difference should be investigated to ensure that the correct number of pensioners is being reported to the actuary.	Responsible Officer: Reporting Manager Due Date: 28 Feb 2016	This issue was raised with the pension's administrator, who confirmed that the difference was due to a timing difference in the removal of pensioners following death between the payroll and pensions administration systems, the latter system being used to provide the figures to the actuary. Work has been undertaken by the pensions administrator in the current year to reduce these timing differences and a reconciliation of these figures shows this has fallen to 20 for 2015/16.

Audit differences

This appendix sets out the audit differences.

The financial statements have been amended for all of the errors identified through the audit process.

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 (which in your case is the PCC and CC). 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.

Uncorrected audit differences

We confirm that there are no uncorrected misstatements, other than those that we believe are clearly trivial.

Corrected audit differences

Material misstatements

The following material misstatements have been identified from our audit and it is our understanding that these will be adjusted. However, we have not yet received a revised set of financial statements to confirm this:

1) A cash deposit of £4 million that did not meet the definition of a 'cash and cash equivalent' had incorrectly been classified as such rather than as an investment. This misstatement affects the PCC's financial statements.

Non-material misstatements

Our audit identified a number of other significant audit differences in the financial statements. These have been discussed with management and it is our understanding that these will be adjusted. However, we have not yet received a revised set of financial statements to confirm this:

2) The consolidation of the property, plant and equipment assets of the regional collaboration (EMSOU) failed to correctly reflect the detailed classification and in year movements, resulting in adjustments totalling £1 million. This misstatement affects the PCC's financial statements;

3) Non-distributed costs of £104k have been incorrectly classified as corporate and democratic core within the comprehensive income and expenditure statement. This misstatement affects the PCC's financial statements; and

4) Capital grant releases from the capital grants receipts in advance account of £691k have incorrectly been taken to the cost of services within the comprehensive income and expenditure statement, rather than being shown within taxation and non-specific grant income. This misstatement affects the both the PCC and CC's financial statements.

Audit differences (cont.)

Disclosure errors

In addition to the above errors that relate directly to the primary statements or their related notes, our audit also identified a number of errors in relation to other disclosures. These have been discussed with management and again it is our understanding that these will be adjusted. However, we have not yet received a revised set of financial statements to confirm this:

- Leases: The amount recoded within the leasing note for the net carrying value of leased assets was understated by £4.1 million. This error affects the PCC's financial statements;
- Cash flow statement: £1.2 million of movements within the supporting cash flow notes had been incorrectly analysed between categories . This error affects the PCC's financial statements;
- Segmental reporting: The financial statements do not present in the format required by the Code the amounts reported for resource allocation decisions. This error affects both the PCC and CC's financial statements;
- Gross expenditure and income: The table presented within the accounts presented for audit was incorrect, representing the position for the CC rather than the group. This error affects the PCC's financial statements;
- Exit packages: This note required by the Code had not been presented in the prescribed format required. This error affects both the PCC and CC's financial statements;
- Retirement benefits: Actuarial gains of £678k had been incorrectly shown as a loss within one of the pension tables resulting in internal inconsistencies between the related pension notes. This error affects both the PCC and CC's financial statements; and
- Financial instruments: The change in fair value of PWLB loans has been incorrectly calculated resulting in an understatement of £129k. This error affects the PCC's financial statements.

Declaration of independence and objectivity

The Code of Audit Practice requires us to exercise our professional judgement and act independently of both Public Sector Audit Appointments Ltd and the PCC and CC.

Requirements

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

'Auditors and their staff should exercise their professional judgement and act independently of both the Commission and the audited body. Auditors, or any firm with which an auditor is associated, should not carry out work for an audited body that does not relate directly to the discharge of auditors' functions, if it would impair the auditors' independence or might give rise to a reasonable perception that their independence could be impaired.'

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

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

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

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

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

General procedures to safeguard independence and objectivity

KPMG's reputation is built, in great part, upon the conduct of our professionals and their ability to deliver objective and independent advice and opinions. That integrity and objectivity underpins the work that KPMG performs and is important to the regulatory environments in which we operate. All partners and staff have an obligation to maintain the relevant level of required independence and to identify and evaluate circumstances and relationships that may impair that independence.

Declaration of independence and objectivity (cont.)

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the PCC and CC's financial statements.

Acting as an auditor places specific obligations on the firm, partners and staff in order to demonstrate the firm's required independence. KPMG's policies and procedures regarding independence matters are detailed in the *Ethics and Independence Manual* ('the Manual'). The Manual sets out the overriding principles and summarises the policies and regulations which all partners and staff must adhere to in the area of professional conduct and in dealings with clients and others.

KPMG is committed to ensuring that all partners and staff are aware of these principles. To facilitate this, a hard copy of the Manual is provided to everyone annually. The Manual is divided into two parts. Part 1 sets out KPMG's ethics and independence policies which partners and staff must observe both in relation to their personal dealings and in relation to the professional services they provide. Part 2 of the Manual summarises the key risk management policies which partners and staff are required to follow when providing such services.

All partners and staff must understand the personal responsibilities they have towards complying with the policies outlined in the Manual and follow them at all times. To acknowledge understanding of and adherence to the policies set out in the Manual, all partners and staff are required to submit an annual ethics and independence confirmation. Failure to follow these policies can result in disciplinary action.

Auditor declaration

In relation to the audit of the financial statements of the Police and Crime Commissioner for Lincolnshire and the Chief Constable for Lincolnshire for the financial year ending 31 March 2015, we confirm that there were no relationships between KPMG LLP and the Police and Crime Commissioner for Lincolnshire and the Chief Constable for Lincolnshire, 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.

Materiality and reporting of audit differences

For 2015/16 our materiality is £2 million for the PCC and CC's accounts.

We have reported all audit differences over £100k for the PCC and CC's accounts to the PCC and CC respectively.

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 used the same planning materiality reported in our External Audit Plan 2015/16, presented to you in March 2016.

Materiality for the PCC and CC's accounts was set at £2 million which equates to around 1.2 percent of the group gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the PCC and CC

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 PCC and CC 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 PCC and CC, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £100k for the PCC and CC.

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

KPMG Audit quality framework

We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG.

The diagram summarises our approach and each level is expanded upon.

At KPMG we consider audit quality is not just about reaching the right opinion, but how we reach that opinion. KPMG views the outcome of a quality audit as the delivery of an appropriate and independent opinion in compliance with the auditing standards. It is about the processes, thought and integrity behind the audit report. This means, above all, being independent, compliant with our legal and professional requirements, and offering insight and impartial advice to you, our client.

KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG. We use our seven drivers of audit quality to articulate what audit quality means to KPMG.

We believe it is important to be transparent about the processes that sit behind a KPMG audit report, so you can have absolute confidence in us and in the quality of our audit.

Tone at the top: We make it clear that audit quality is part of our culture and values and therefore non-negotiable. Tone at the top is the umbrella that covers all the drives of quality through a focused and consistent voice. Andrew Cardoza as the Engagement Lead sets the tone on the audit and leads by example with a clearly articulated audit strategy and commits a significant proportion of his time throughout the audit directing and supporting the team.

Association with right clients: We undertake rigorous client and engagement acceptance and continuance procedures which are vital to the ability of KPMG to provide high-quality professional services to our clients.

Clear standards and robust audit tools: We expect our audit professionals to adhere to the clear standards we set and we provide a range of tools to support them in meeting these expectations. The global rollout of KPMG's eAudIT application has significantly enhanced existing audit functionality. eAudIT enables KPMG to deliver a highly technically enabled audit. All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the National Audit Office's Code of Audit Practice.

Recruitment, development and assignment of appropriately qualified personnel: One of the key drivers of audit quality is assigning professionals appropriate to the PCC and CC's risks. We take great care to assign the right people to the right clients based on a number of factors including their skill set, capacity and relevant experience.

We have a well developed technical infrastructure across the firm that puts us in a strong position to deal with any emerging issues. This includes:

- A national public sector technical director who has responsibility for co-ordinating our response to emerging accounting issues, influencing accounting bodies (such as CIPFA) as well as acting as a sounding board for our auditors.
- A national technical network of public sector audit professionals is established that meets on a monthly basis and is chaired by our national technical director.
- All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the National Audit Office's Code of Audit Practice.
- A dedicated Department of Professional Practice comprised of over 100 staff that provide support to our audit teams and deliver our web-based quarterly technical training.

KPMG Audit quality framework (cont.)

We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

Quality must build on the foundations of well trained staff and a robust methodology.

Commitment to technical excellence and quality service delivery: Our professionals bring you up-the-minute and accurate technical solutions and together with our specialists are capable of solving complex audit issues and delivering valued insights.

Our audit team draws upon specialist resources including Forensic, Corporate Finance, Transaction Services, Advisory, Taxation, Actuarial and IT. We promote technical excellence and quality service delivery through training and accreditation, developing business understanding and sector knowledge, investment in technical support, development of specialist networks and effective consultation processes.

Performance of effective and efficient audits: We understand that how an audit is conducted is as important as the final result. Our drivers of audit quality maximise the performance of the engagement team during the conduct of every audit. We expect our people to demonstrate certain key behaviours in the performance of effective and efficient audits. The key behaviours that our auditors apply throughout the audit process to deliver effective and efficient audits are outlined below:

- Timely Engagement Lead and manager involvement;
- Critical assessment of audit evidence;
- Exercise of professional judgment and professional scepticism;
- Ongoing mentoring and on the job coaching, supervision and review;
- Appropriately supported and documented conclusions;
- If relevant, appropriate involvement of the Engagement Quality Control reviewer (EQC review);
- Clear reporting of significant findings;
- Insightful, open and honest two-way communication with those charged with governance; and
- Client confidentiality, information security and data privacy.

Commitment to continuous improvement: We employ a broad range of mechanisms to monitor our performance, respond to feedback and understand our opportunities for improvement.

Our quality review results

Public Sector Audit Appointments Ltd publishes information on the quality of work provided by us (and all other firms) for audits undertaken on behalf of them (http://www.psaa.co.uk/audit-quality/principal-audits/kpmg-audit-quality/).

The latest Annual Regulatory Compliance and Quality Report (issued June 2015) showed that we are meeting the overall audit quality and regulatory compliance requirements.

kpmg.com/uk

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

KPMG LLP is multi-disciplinary practice authorised and regulated by the Solicitors Regulation PCC and CC. For full details of our professional regulation please refer to ‘Regulatory Information’ at www.kpmg.com/uk