

# Audit plan

Nottingham City Council

Audit 2011/12



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# Introduction

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**This plan sets out the work for the 2011/12 audit. The plan is based on the Audit Commission's risk-based approach to audit planning.**

## **Responsibilities**

The Audit Commission's Statement of Responsibilities of Auditors and of Audited Bodies sets out the respective responsibilities of the auditor and the audited body. The Audit Commission has issued a copy of the Statement to you.

The Statement summarises where the different responsibilities of auditors and of the audited body begin and end and I undertake my audit work to meet these responsibilities.

I comply with the statutory requirements governing my audit work, in particular:

- the Audit Commission Act 1998; and
- the Code of Audit Practice for local government bodies.

My audit does not relieve management or the Audit Committee, as those charged with governance, of their responsibilities.

# Accounting statements and Whole of Government Accounts

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I will carry out the audit of the accounting statements in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB). I am required to issue an audit report giving my opinion on whether the accounts give a true and fair view.

## Materiality

I will apply the concept of materiality in planning and performing my audit, in evaluating the effect of any identified misstatements, and in forming my opinion.

## Identifying audit risks

I need to understand the Authority to identify any risk of material misstatement (whether due to fraud or error) in the accounting statements. I do this by:

- identifying the business risks facing the Authority, including assessing your own risk management arrangements;
- considering the financial performance of the Authority;
- assessing internal control, including reviewing the control environment, the IT control environment and internal audit; and
- assessing the risk of material misstatement arising from the activities and controls within the Authority's information systems.

## Identification of significant and other specific risks

I have considered the additional risks that are relevant to the audit of the accounting statements.

I have identified three significant risks which require special audit attention and a number of other specific risks related to the audit of your 2011/12 financial statements these are set out in the following tables along with our audit response.

Table 1: **Significant risks**

Risk	Audit response
<p><b>Heritage Assets</b></p> <p>The 2011/12 Code adopts the requirements of FRS 30 Heritage Assets.</p> <p>A heritage asset is a tangible asset with historical, artistic, scientific, technological, geophysical or environmental qualities that is held and maintained principally for its contribution to knowledge and culture.</p> <p>The Council has carried out an exercise to identify and review heritage assets using criteria set out in FRS 30. It has also determined its proposed accounting treatment and disclosures for these assets.</p> <p>However, there remains a risk that the Council's may not comply fully with the accounting and disclosure requirements of FRS 30 leading to a material accounting or disclosure error in the financial statements.</p>	<p>Evaluation of the management controls you have in place to recognise and value heritage assets.</p> <p>Testing to check that the Council has accounted for heritage assets in accordance with FRS 30 and the CIPFA Code of Practice for 2011/12.</p>
<p><b>Nottingham Express Transit (NET) phase 2</b></p> <p>In December 2011 the Council entered into a major new PFI scheme when it awarded a concession to Tramlink Nottingham for the NET phase 2 extension. As this also includes operation of the existing network, the existing PFI concession with Arrow Light Rail Limited ceased at the same time.</p> <p>Early cessation of an existing PFI scheme linked to the inception of a new one will require a number of complex financial transactions and disclosures in the Council's financial statements. The Council has sought external advice on these matters.</p> <p>Increased risk of material error in the financial statements due to complex accounting transactions and disclosures for both the existing and new NET PFI schemes.</p>	<p>Continued specialist technical input to support our evaluation of the management controls you have in place.</p> <p>As required review your proposed accounting treatment and financial transactions based on your external financial advice on PFI transactions.</p> <p>Tests of detail on the disclosures in the financial statements including consistency with the financial model.</p>

Risk	Audit response
<p><b>HRA reform</b></p> <p>The government plans to reform local authority housing finance by adopting a self-financing model from 1 April 2012. This will be through a one-off settlement payment to central government on or before 28 March 2012. This will adjust the HRA debt of the Authority. Due to the complexity, magnitude and timing of the HRA reform there is risk that the financial statements will be materially misstated.</p>	<p>Review of management oversight of HRA reforms and transactions required by the Authority.</p> <p>Tests of detail on the settlement payment or receipt.</p>

Table 2: **Other specific risks**

Risk	Audit response
<p><b>Accounts payable</b></p> <p>I stated in my 2010/11 annual governance report that controls in this area remained weak following the introduction of new Accounts Payable arrangements in August 2009. Extra audit testing was required to provide me with sufficient assurance over expenditure to inform my 2010/11 opinion.</p> <p>Steps are being taken by the Council in 2011/12 to address these weaknesses. Risk that action being taken is insufficient and would lead to a material error in the financial statements.</p>	<p>I will review the Council's accounts payable system (including consideration of relevant work undertaken by Internal Audit) and assess whether any assurance is available to me from the Council's internal controls in this area.</p> <p>In the absence of any controls related assurance, extensive substantive testing of expenditure transactions will be required as last year.</p>
<p><b>Payroll</b></p> <p>I reported in my 2010/11 annual governance report that the Council did not maintain an up to date establishment list.</p> <p>The absence of any establishment related checks increases the risk of material error in payroll costs within the financial statements. Last year, this weakness made it more difficult to obtain assurance that payroll costs were complete and accurate.</p>	<p>I will carry out extra testing of the accuracy and completeness of payroll costs.</p> <p>Work is being carried out by the Council in 2011/12 to validate its payroll before transfer to EMSS in 2012/13. I understand that this exercise includes a check on the existence of all Council staff on the payroll by Service area.</p>

## Risk

For 2011/12, the Council has already ascertained its budgeted establishment and vacant posts with additional controls put in place. It expects to complete ongoing work to validate existing payroll information by mid April 2012.

Looking ahead, the Council will transfer its HR and Financial Services to East Midlands Shared Services (EMSS) in 2012/13. Full establishment controls will be an integral part of the new EMSS Oracle system and is expected to address previous weaknesses.

### Related party transactions

I concluded in my 2010/11 annual governance report that operation of the Council's process for identifying related parties had improved but remains limited in its effectiveness.

The response rate for member and senior officer declarations of related party transactions in 2010/11 (74 per cent) fell short of a full (100 per cent) response. Action is being taken by the Council to improve operation of the process for 2011/12.

Increased risk of undisclosed material transactions.

### De-recognition of Property, Plant and Equipment (PPE)

The Council implemented component accounting for the first time in 2010/11. This included the requirement to de-recognise (dispose of) components that have been replaced.

I reported in my 2010/11 annual governance report that the Council had insufficient information to allow de-recognised amounts to be calculated accurately. Management estimated a range of values for de-recognised amounts to support its assumption that de-recognition was immaterial to the 2010/11 financial statements.

During 2011/12, the Council has developed a method to calculate de-recognised amounts and plans to collect the extra information required.

## Audit response

I will review this exercise and assess whether this provides sufficient assurance to confirm the existence of staff listed on the Council's payroll.

If this exercise provides insufficient or no assurance, as in previous years substantial extra work will be required to verify the existence of a sample of employees listed on the Council's payroll.

I will review the Council's arrangements to identify and disclose related party transactions for 2011/12. Member and senior officer response rates for related party transactions will be considered.

I will also follow up the recommendation for improvement in this area that I made in my 2010/11 annual governance report.

I will assess the Council's method for de-recognising replaced assets and test the accuracy of supporting calculations.

Risk	Audit response
<p>Risk of material estimation uncertainty and error linked to de-recognition of components.</p> <p><b>HRA – valuation</b></p> <p>The value of the Council’s housing stock may be materially misstated if the Council does not comply fully with the CIPFA Code of Practice 2011/12 and the Housing Revenue Account (Accounting Practices) Direction 2011 when preparing HRA asset valuations.</p>	<p>Review of management oversight of the valuation of housing stock, including arrangements for instructing a valuer and controls over information provided to valuer.</p> <p>Procedures for reliance on the work of the valuer.</p> <p>Tests of detail on valuation calculations.</p>

## Group accounts

I am responsible for the direction, supervision and performance of the group audit. Auditing standards require me to communicate when planning the group audit with the auditors of any components (group companies) that I consider to be significant. These components are:

- Nottingham City Homes Limited; and
- Nottingham City Transport Limited.

I will also contact the auditors of the following components as part of my audit procedures.

- Nottingham Ice Centre Limited.
- Enviroenergy Limited.
- Nottingham and Nottinghamshire Futures Limited.
- GuideLine Career Services Limited.

Please discuss with me any concerns about me contacting component auditors.

## Testing strategy

My audit involves:

- review and re-performance of work of your internal auditors;
- testing of the operation of controls;
- reliance on the work of other auditors (group financial statements);



- reliance on the work of experts; and
- substantive tests of detail of transactions and amounts.

I have sought to:

- maximise reliance, subject to review and re-performance, on the work of your internal auditors; and
- maximise the work that can be undertaken before you prepare your accounting statements.

The nature and timing of my proposed work is as follows.

Table 3: **Proposed work**

	Review of internal audit	Controls testing	Reliance on the work of other auditors	Reliance on work of experts	Substantive testing
Pre-statements work	Estate rents General ledger	General ledger Creditors Assessment of management controls linked to significant risks.			Non-current assets (property, plant and equipment) – ownership and existence testing. Payroll – staff verification testing.
Post-statements work	Housing benefits		Group companies – Smith Cooper (Nottingham Ice Centre Ltd); PKF UK LLP (Nottingham City Transport Ltd); RSM Tenon (Enviroenergy Ltd, Nottingham and Nottinghamshire Futures Ltd, Guideline Career Services Ltd); Grant Thornton UK LLP (Nottingham City Homes Ltd) Pensions assets and liabilities – auditor to Nottinghamshire County Council Pension Fund.	Pensions liabilities and assets – Barnett Waddingham and our own consulting actuary. Valuation of property, plant and equipment – Nottingham City Council Property Department; Freeman and Mitchell; Herbert Button and Partners.	All material accounts balances and amounts. Year-end feeder system reconciliations.

I will agree with you a schedule of working papers required to support the entries in the accounting statements.

## **Whole of Government Accounts**

Alongside my work on the accounting statements, I will also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of my review and the nature of my report are specified by the National Audit Office.

# Value for money

## I am required to reach a conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness.

My conclusion on the Authority's arrangements is based on two criteria, specified by the Commission. These relate to the Authority's arrangements for:

- securing financial resilience – focusing on whether the Authority is managing its financial risks to secure a stable financial position for the foreseeable future; and
- challenging how the Council secures economy, efficiency and effectiveness – focusing on whether the Authority is prioritising its resources within tighter budgets and improving productivity and efficiency.

### Identification of significant risks

I have considered the risks that are relevant to my value for money conclusion. I have identified the following significant risks that I will address through my work.

Table 4: **Significant risks**

Risk	Audit response	Separate audit output?
<b>Financial governance</b> Non-compliance with standing orders on procurement linked to grants.	Review follow-up action taken by the Council in response to the findings and recommendations in our 2010/11 Future Jobs Fund report.	No.

# Key milestones and deadlines

The Authority is required to prepare and approve the accounting statements by 30 June 2012. I aim to complete my work and issue my opinion and value for money conclusion by 30 September 2012.

Table 5: **Proposed timetable and planned outputs**

Activity	Date	Output
Opinion: controls and early substantive testing	January to March 2012	
Opinion: receipt of accounts and supporting working papers	By 30 June 2012	
Opinion: substantive testing	July to September 2012	
Value for money: assessment update	September 2012	
Present Annual Governance Report at the Audit Committee	21 September 2012 (TBC)	Annual Governance Report
Issue opinion and value for money conclusion	By 28 September 2012	Auditor's report
Summarise overall messages from the audit	October 2012	Annual Audit Letter

# The audit team

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The key members of the audit team for the 2011/12 audit are as follows.

Table 6: **Audit team**

Name	Contact details	Responsibilities
Sue Sunderland District Auditor	<a href="mailto:s-sunderland@audit-commission.gov.uk">s-sunderland@audit-commission.gov.uk</a>	Responsible for the overall delivery of the audit including quality of reports, signing the auditor's report and liaison with the Chief Executive.
Paul Hutchings Audit Manager	<a href="mailto:p-hutchings@audit-commission.gov.uk">p-hutchings@audit-commission.gov.uk</a> 0844 798 4545	Manages and coordinates the different elements of the audit work. Key point of contact for the Director of Finance.
Laura Miller Principal Auditor (Team Leader)	<a href="mailto:l-miller@audit-commission.gov.uk">l-miller@audit-commission.gov.uk</a> 0844 798 4108	Supervises day to day work of the audit team.

# Independence and quality

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## Independence

I comply with the ethical standards issued by the APB and with the Commission's additional requirements for independence and objectivity as summarised in appendix 1.

I am not aware of any relationships that may affect the independence and objectivity of the Audit Commission, the audit team or me, that I am required by auditing and ethical standards to report to you.

## Quality of service

I aim to provide you with a fully satisfactory audit service. If, however, you are unable to deal with any difficulty through me and my team please contact Chris Westwood, Director – Standards & Technical, Audit Practice, Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ ([c-westwood@audit-commission.gov.uk](mailto:c-westwood@audit-commission.gov.uk)) who will look into any complaint promptly and to do what he can to resolve the position.

If you are still not satisfied you may of course take up the matter with the Audit Commission's Complaints Investigation Officer (The Audit Commission, Westward House, Lime Kiln Close, Stoke Gifford, Bristol BS34 8SR).

# Fees

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**The fee for the audit is £380,700 as set out in my letter of 9 April 2011.**

## The audit fee

The Audit Commission has set a scale audit fee of £380,700 which represents a 10 per cent reduction on the scale audit fee for 2010/11.

The scale fee covers:

- my audit of your accounting statements and reporting on the Whole of Government Accounts return; and
- my work on reviewing your arrangements for securing economy, efficiency and effectiveness in your use of resources.

The scale fee reflects:

- the Audit Commission's decision not to increase fees in line with inflation;
- a reduction resulting from the new approach to local VFM audit work; and
- a reduction following the one-off work associated with the first-time adoption of International Financing Reporting Standards (IFRS).

Variations from the scale fee only occur where my assessments of audit risk and complexity are significantly different from those reflected in the 2010/11 fee. I have not identified significant differences and have therefore set the fee equal to the scale fee.

## Assumptions

In setting the fee, I have made the assumptions set out in appendix 2. Where these assumptions are not met, I may be required to undertake more work and therefore increase the audit fee. Where this is the case, I will discuss this first with your Deputy Chief Executive and Corporate Director of Resources and I will issue a supplement to the plan to record any revisions to the risk and the impact on the fee.

## Specific actions you could take to reduce your audit fee

The Audit Commission requires me to inform you of specific actions you could take to reduce your audit fee. The following actions have been undertaken by the Council but additional audit work may be required for 2011/12 to gain assurance on the controls and processes put in place:

- Payroll – introduce a formal establishment list for authority employees supported by regular staff verification checks; and
- Creditors – address previously reported control weaknesses related to the authority's Accounts Payable system.

Implementation of these actions would reduce the level of work I am required to carry out.

## Total fees payable

In addition to the fee for the audit, the Audit Commission will charge fees for:

- certification of claims and returns; and
- the agreed provision of non-audit services under the Audit Commission's advice and assistance powers.

Based on current plans the fees payable are as follows.

Table 7: Fees

	2011/12 proposed	2010/11 actual	Variance
Audit	£380,700	£423,000	£42,300 reduction
Certification of claims and returns	£64,200	£51,800	£12,400 increase
<b>Total</b>	<b>£444,900</b>	<b>£474,800</b>	<b>£29,900 reduction</b>



# Appendix 1 – Independence and objectivity

Auditors appointed by the Audit Commission must comply with the Commission’s Code of Audit Practice and Standing Guidance for Auditors. When auditing the accounting statements, auditors must also comply with professional standards issued by the Auditing Practices Board (APB). These impose stringent rules to ensure the independence and objectivity of auditors. The Audit Practice puts in place robust arrangements to ensure compliance with these requirements, overseen by the Audit Practice’s Director – Standards and Technical, who serves as the Audit Practice’s Ethics Partner.

Table 8: **Independence and objectivity**

Area	Requirement	How we comply
Business, employment and personal relationships	<p>Appointed auditors and their staff should avoid any official, professional or personal relationships which may, or could reasonably be perceived to, cause them inappropriately or unjustifiably to limit the scope, extent or rigour of their work or impair the objectivity of their judgement.</p> <p>The appointed auditor and senior members of the audit team must not take part in political activity for a political party, or special interest group, whose activities relate directly to the functions of local government or NHS bodies in general, or to a particular local government or NHS body.</p>	<p>All audit staff are required to declare all potential threats to independence. Details of declarations are made available to appointed auditors. Where appropriate, staff are excluded from engagements or safeguards put in place to reduce the threat to independence to an acceptably low level.</p> <p>I can confirm that there have been no changes to the declarations made in 2010 which were discussed with the Deputy Chief Executive and Corporate Director for Resources and where it was confirmed that these did not present a threat to our independence.</p>

Area	Requirement	How we comply
Long association with audit clients	The appointed auditor responsible for the audit should, in all but the most exceptional circumstances, be changed at least once every seven years, with additional consideration of threats to independence after five years.	The Audit Practice maintains and monitors a central database of assignment of auditors and senior audit staff to ensure this requirement is met.
Gifts and hospitality	The appointed auditor and members of the audit team must abide by the Commission's policy on gifts, hospitality and entertainment.	All audit staff are required to declare any gifts or hospitality irrespective of whether or not they are accepted. Gifts and Hospitality may only be accepted with line manager approval.
Non-audit work	<p>Appointed auditors should not perform additional work for an audited body (that is work above the minimum required to meet their statutory responsibilities) if it would compromise their independence or might result in a reasonable perception that their independence could be compromised.</p> <p>Auditors should not accept engagements that involve commenting on the performance of other auditors appointed by the Commission on Commission work without first consulting the Commission.</p> <p>Work over a specified value must only be undertaken with the prior approval of the Audit Commission's Director of Audit Policy and Regulation.</p>	All proposed additional work is subject to review and approval by the appointed auditor and the Director – Standards and Technical, to ensure that independence is not compromised.

*Code of Audit Practice, Audit Commission Standing Guidance and APB Ethical Standards*

# Appendix 2 – Basis for fee

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In setting the fee, I have assumed the following.

- The risk in relation to the audit of the accounting statements is not significantly different to that identified for 2010/11. For example:
  - internal controls are operating effectively;
  - the timely co-operation of other auditors is received; and
  - there are no significant developments affecting the audit over and above those already included in this plan.
- The risk in relation to my value for money responsibilities is not significantly different to that identified for 2010/11.
- Internal Audit meets professional standards.
- Internal Audit undertakes sufficient appropriate work on all systems that provide material figures in the accounting on which I can rely.
- The Authority provides:
  - good quality working papers and records to support the accounting statements and the text of the other information to be published with the statements by 30 June 2012;
  - other information requested within agreed timescales;
  - prompt responses to draft reports; and
- there are no questions asked or objections made by local government electors.

Where these assumptions are not met, I will have to undertake more work which is likely to result in an increased audit fee.

# Appendix 3 – Glossary

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## **Accounting statements**

The annual statement of accounts that the Authority is required to prepare, which report the financial performance and financial position of the Authority in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Authority Accounting in the United Kingdom.

## **Annual Audit Letter**

Report issued by the auditor to the Authority after the completion of the audit that summarises the audit work carried out in the period and significant issues arising from auditors' work.

## **Annual Governance Report**

The auditor's report on matters arising from the audit of the accounting statements presented to those charged with governance before the auditor issues their opinion [and conclusion].

## **Annual Governance Statement**

The annual report on the Authority's systems of internal control that supports the achievement of the Authority's policies aims and objectives.

## **Audit of the accounts**

The audit of the accounts of an audited body comprises all work carried out by an auditor under the Code to meet their statutory responsibilities under the Audit Commission Act 1998.

## **Audited body**

A body to which the Audit Commission is responsible for appointing the external auditor.

## **Auditing Practices Board (APB)**

The body responsible in the UK for issuing auditing standards, ethical standards and associated guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

## **Auditing standards**

Pronouncements of the APB that contain basic principles and essential procedures with which auditors must comply, except where otherwise stated in the auditing standard concerned.

## **Auditor(s)**

Auditors appointed by the Audit Commission.

## **Code (the)**

The Code of Audit Practice for local government bodies issued by the Audit Commission and approved by Parliament.

## **Commission (the)**

The Audit Commission for Local Authorities and the National Health Service in England.

## **Ethical Standards**

Pronouncements of the APB that contain basic principles relating to independence, integrity and objectivity that apply to the conduct of audits and with which auditors must comply, except where otherwise stated in the standard concerned.

## **Group accounts**

Consolidated accounting statements of an Authority and its subsidiaries, associates and jointly controlled entities.

## **Internal control**

The whole system of controls, financial and otherwise, that the Authority establishes to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

## **Materiality**

The APB defines this concept as ‘an expression of the relative significance or importance of a particular matter in the context of the accounting statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor’s report; likewise a misstatement is material if it would have a similar influence. Materiality may also be considered in the context of any individual primary statement within the accounting statements or of individual items included in them. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative aspects’.

The term ‘materiality’ applies only to the accounting statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the accounting statements, which do not necessarily affect their opinion on the accounting statements.

## **Significance**

The concept of ‘significance’ applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit of the accounting statements. Significance has both qualitative and quantitative aspects.

## **Those charged with governance**

Those entrusted with the supervision, control and direction of the Authority. This term includes the members of the Authority and its Audit Committee.

## **Whole of Government Accounts**

A project leading to a set of consolidated accounts for the entire UK public sector on commercial accounting principles. The Authority must submit a consolidation pack to the department for Communities and Local Government which is based on, but separate from, its accounting statements.

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The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors, members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

