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NOTTINGHAM CITY COUNCIL

AUDIT COMMITTEE

MINUTES of the meeting held at LB 31 - Loxley House, Station Street, Nottingham, NG2 3NG on 20 July 2018 from 11.30 am - 1.05 pm

Membership

Present

Councillor Michael Edwards (Chair)
Councillor Leslie Ayoola
Councillor Cheryl Barnard
Councillor John Hartshorne
Councillor Rosemary Healy
Councillor Anne Peach
Councillor Andrew Rule
Councillor Adele Williams
Councillor Steve Young

Absent

Colleagues, partners and others in attendance:

Nancy Barnard	- Governance Manager
Theresa Channell	- Head of Strategic Finance
Tony Crawley	- KPMG External Auditor
Arvinder Khela	- KPMG External Auditor
Jonny Kirk	- Access to Learning Service Manager
Nick Lee	- Head of Access and Learning
Laura Pattman	- Strategic Director of Finance
Sue Risdall	- Financial Team Leader, Technical Accounting
Shail Shah	- Head of Audit and Risk
John Slater	- Group Auditor
Tom Straw	- Technical Finance
Tom Tandy	- KPMG External Auditor

15 APOLOGIES FOR ABSENCE

None

16 DECLARATIONS OF INTEREST

None

17 MINUTES

The minutes of the meeting held on 22 June 2018 were confirmed as a correct record and signed by the Chair.

18 STATEMENT OF ACCOUNTS 2017/18

The Chair agreed to take agenda items 4 and 5 at the same time.

Tony Crawley, Tom Tandy and Arvinder Khela of KPMG presented the External Audit ISA260 Report 2017/18 to the Committee which summarised the key findings in relation to KPMG's 2017/18 external audit at Nottingham City Council. They also circulated a letter dated 18 July 2018 to Committee members. The letter was added to the agenda after the meeting. During the presentation of the report, the following points were highlighted:

- a) Nottingham City Council's accounts are very complex and the timescale for submission this year was shortened. Despite this, the auditors reported an impressive level of co-operation from finance colleagues in providing accounts from across the group by the deadline. KPMG expressed their thanks to colleagues for this.
- b) Regarding the process for signing off the accounts, the majority of Councils do this one week later than Nottingham. Tony Crawley suggested that delaying this meeting by one week next year might be beneficial.
- c) The Auditors' key findings were summarised as follows:
 - i) Organisational and IT control environment
No significant issues were identified and overall arrangements in place are reasonable.
 - ii) Controls over key financial systems
The majority of key financial systems are sound. A recommendation was made in relation to building journal controls into the fit for the future programme.
 - iii) Accounts Production
The overall process is sound and accounting practices are appropriate
 - iv) Financial statements
Three significant risks were identified: Valuation of PPE, Pensions Liabilities and Faster Close. Recommendations were made and identified in the report.
 - v) Value for money arrangements
The Authority has "made proper arrangements to secure economy, efficiency and effectiveness in its use of resources" but still faces significant challenges and uncertainty going forward and Delivery of Budgets and Group Governance were identified as significant Value for Money Audit Risks. The auditors emphasised the need to look at any non-recurrent measures that have been taken to address recurrent problems and stressed the need to continue developing a framework to support an understanding of Group Governance arrangements by September.
 - vi) Exercising of audit powers
The auditors confirmed that they had not identified any matters that would require them to issue a public interest report.
- d) A minor breach of auditor independence requirements was identified in relation to Nottingham City Council's status as an EU Public Interest Entity (EU PIE). The auditors were not aware of this status when carrying out some work for Nottingham City Transport but the work would not have been approved if the EU PIE status had been known at the time because it breaches independence requirements as detailed in the additional letter circulated to the Committee at the meeting. The letter also outlined that although the independence requirements had been breached, in KPMG's view, the impact was minor and, in the auditor's professional judgement, they concluded that their objectivity has not been

compromised and KPMG continues to be independent of the Council and its controlled entities for the year ended 31 March 2018. The Strategic Director of Finance and Head of Audit and Risk confirmed that they supported the conclusions of the auditors.

During the discussion that followed the presentation, the following points were made:

- e) Due to the timetabling of the accounts, there had not been the opportunity to include responsible officers or implementation deadlines against the recommendations. These would be added and a revised version circulated to Committee members by the Head of Audit and Risk.
- f) The findings relating to Group organisations would be communicated to those organisations by the responsible officer.
- g) The head of Audit and Risk acknowledged that this would be the last opinion provided by KPMG due to a change in auditors and thanked KPMG for their invaluable support and guidance.

Sue Risdall, Financial Team Leader, Technical Accounting then presented Nottingham City Council's Statement of Accounts 2017/18 to the committee. During the presentation and the subsequent discussion the following points were highlighted:

- h) The version for consideration at this meeting was largely the same as that discussed at the Committee's June meeting subject to some minor wording changes regarding Council Plan achievements and to reflect changes in accounts.
- i) Changes to Portfolio responsibilities year on year make the reporting process more complicated in Nottingham. However the reporting process cannot be changed and therefore this obstacle has to be worked around. Financial Accounting work closely with colleague in the budget team to ensure the process is robust.

RESOLVED to:

- (1) approve the final Statement of Accounts and authorise the Chair of the Audit Committee to sign them on the Committee's behalf;**
- (2) approve the Draft Management Representation Letter for signature by the Chair of the Audit Committee**
- (3) delegate power to the Chair of the Audit Committee and the Strategic Director of Finance to approve any subsequent necessary amendments to the statement of accounts**
- (4) confirm that the committee concur with the KPMG's conclusion that their objectivity has not been compromised and KPMG continues to be independent of the Council and its controlled entities for the year ended 31 March 2018.**

19 ISA 260 REPORT AND SUPPORTING INFORMATION

This item was taken as part of the previous agenda item.

20 ANNUAL GOVERNANCE STATEMENT 2017/18

Shail Shah, Head of Audit and Risk, introduced the report informing the committee that this version was almost identical to that considered at the June meeting but that the committee was required to consider it alongside the Statement of Accounts. The document described the governance arrangements in place at the Council and confirms that while there are no significant issues raised, there are issues worth noting including East Midlands Shared Services, Fit for the Future, Balancing the Council's Budget and some of the Council's wholly owned companies.

Following questions and comments from the Committee, Shail Shah and Theresa Channell provided some additional information:

- a) The outturn figure of a £4.2m overspend is the same as the figure in the accounts for 2017/18,
- b) The Housing Revenue Account (HRA) has been included as an Issue Worth Noting due to the impact of Universal credit and government policy in relation to rent increases which will increase strain on the HRA.
- c) No new Issues Worth Noting were raised this year but those included have been updated to reflect what actions have been taken in the last year.
- d) Compiling the Statement involves a comprehensive process including questionnaires to companies, partners and key officers. Anything raised throughout the process is included, including any findings from Ofsted or other inspections and KPMG.

RESOLVED to approve the Annual Governance Statement 2017/18.

21 INTERNAL AUDIT CHARTER

Shail Shah, Head of Audit and Risk introduced the report explaining that the Charter is effectively the Terms of Reference for the operation of Internal Audit. It outlines the freedoms and powers of the Head of Internal Audit for example in relation to access to documents. Some minor updates have been made to the Charter since its last approval by the Committee.

RESOLVED to approve the Internal Audit Charter.

22 URGENT ITEM - LOCAL GOVERNMENT OMBUDSMAN REPORT ON AN EDUCATION AND CHILDREN'S SERVICES MATTER

In accordance with Section 100B (4) (b) of the Local Government Act 1972 the Chair of the Committee agreed that this item, although not on the agenda, could be considered as a matter of urgency in order to avoid any delay in the Council's response to the Ombudsman's recommendations.

Nick Lee, Head of Access and Learning, Jonny Kirk, Access to Learning Service Manager and Nancy Barnard, Governance Manager presented the report to the Committee, outlining the following key points.

- a) The Local Government and Social Care Ombudsman (LGO) has found fault with the Council's processes in relation to a school admission appeal and has published a report on its findings. When the LGO publishes a report, the authority is obliged to take the report to a meeting of Council or a Committee with delegated authority to consider such reports.
- b) The final report and its findings had been subject to substantial amendment by the LGO following concerns raised by colleagues in relation to the process followed during the investigation and the content of earlier versions.
- c) Throughout the investigatory process, the parent was offered alternative school places for the child but these were not accepted by the parent. The child is now finishing year six and will be starting secondary school in September.
- d) In complying with the LGO's recommendations colleagues will provide training to all appeals personnel and will offer a re-hearing to the parent. A plan in relation to these actions will be shared with members of the committee.
- e) Efforts have been made seeking to increase the diversity of the pool of voluntary independent Panel members. The Governance Manager will be meeting with Cllr Ayoola to identify any further possible actions that could be taken.

RESOLVED to agree that the relevant services should comply with the recommendations of the Local Government Ombudsman.

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Our ref

Contact Amanda Morrison

18 July 2018

Dear Directors

Breach of auditor independence requirements and assessment of our objectivity and independence as auditor of Nottingham City Council

I am writing to advise you that we have identified a breach of the auditor independence requirements relating to the provision of a prohibited non-audit service in accordance with the FRC Ethical Standard ('FRC ES') to Nottingham City Council ('the Council'), which is a public interest entity as defined under the FRC ES, impacting the year ended 31 March 2018.

Our professional standards require that where the firm has determined that a breach of an independence standard has occurred, we discuss the breach and the actions we have taken/propose to take with you as soon as possible, and to communicate with you in writing all matters discussed and obtain your concurrence that action can be, or has been, taken to satisfactorily address the consequences of the breach. This letter is intended to comply with these requirements.

What was the breach?

Nottingham City Council is a public interest entity as defined under the FRC ES due to the debt instruments which the Council has listed on the main market of the London Stock Exchange. However, as the debt was registered in the name of Nottingham Corporation and given the immaterial value of the debt concerned (£617,000), the audit team were not aware of the existence of the listed debt instrument until advised by our internal quality teams following a firm enquiry from the Audit Quality Review team. As a consequence, the Council was not identified as a listed entity or a public interest entity in our internal compliance systems and, the standard review that our firm undertook for all public interest audit entities of any pre-existing services to identify any prohibited non-audit services which were required to be exited prior to the FRC ES effective date, which for the Council would have been the period commencing 1 April 2017, was not completed.

Once we became aware that the Council was a public interest entity, we performed a review of non-audit services ongoing from 1 April 2017 to identify any services that would not be permissible under the relevant independence requirements. During the course of this review we identified an engagement to provide pension advisory services to Nottingham City Transport



Limited (the 'Company'), a controlled undertaking of the Council, approved on the 23 January 2017. The work concluded and our report was issued in August 2017.

The FRC ES 5.167R prohibits an audit firm of a public interest entity, or any member of the network to which the audit firm belongs, to provide directly or indirectly to the audited entity, to its parent undertaking or to its controlled undertakings within the European Union any prohibited non-audit services. Given the nature of the service provided involved providing advice to the Company on its triennial funding valuation and potential design changes to the scheme, we consider that the service would be a 'human resource services with respect to cost control' – such services are prohibited services in accordance with paragraph 5.167(R) (k) (iii) and therefore the services which were provided to Nottingham City Transport Limited were prohibited in accordance with these requirements. The provision of this service was completed prior to our identification of the breach.

A description of the firm's key policies and procedures to safeguard independence is set out in Attachment 1.

Assessment of the significance of the breach

Given this breach related to the provision of a service which has an absolute prohibition under the requirements of the independence standards in this area, we consider this to be a more significant breach of the independence standards.

Notwithstanding our assessment in this regard, we have concluded the breach did not impact on our independence and objectivity as auditors of the Council for the following reasons and therefore its impact was minor:

1. The advisory services provided were in respect of the triennial funding valuation of the Fund and the provision of advice to the Company in respect of their discussions with the Trustees of the Fund on future funding. Given the nature of these services and the timing of any financial impact agreed between the Company and the Trustees, the services have had no impact on the Council's financial statements for the year-ended 31 March 2018. Furthermore, the services did not involve any form of valuation or provide any accounting entries that would give rise to any self-review.
2. Whilst the Company results are consolidated into the Council's results, KPMG are not the auditors of this Company or the Fund, therefore safeguarding any possible self-review threat. No members of the Council's audit team were involved in the work for the Company.
3. Finally, we note that this our last year as auditors of the Council and therefore any future impact on the financials resulting from actions taken as a result of the advice provided under the service, will not be subject to audit by our firm.

Actions taken

In respect of this matter we have taken the following actions:



1. We have updated our internal systems to reflect the status of the Council as a listed entity and as a public interest entity.
2. We have discussed this matter with the Public Sector Audit Appointments ('PSAA' - the appointing and responsible body for oversight of Ethical matters).
3. We have completed a full assessment of non-audit services provided to the Council and all controlled undertakings and can confirm that no other issues have been identified.

Conclusion

Based on the above, in our professional judgment, we have concluded that our objectivity has not been compromised and the firm continues to be independent of the Council and its controlled entities for the year ended 31 March 2018. We would be grateful if you could confirm that you concur with our conclusion in this regard.

We would be pleased to provide any further information you require.

Yours sincerely

KPMG LLP

KPMG LLP

Attachment 1 – Description of the firm's policies and procedures



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General Independence

KPMG member firms and KPMG professionals are required to comply with independence standards that meet or exceed those set out in the IESBA Code of Ethics. In addition, KPMG LLP and our professionals are also required to comply with the ethical standard set by the Financial Reporting Council.

Our firm has a designated Ethics and Independence Partner (EIP) supported by a core team of specialists to help ensure that we implement robust and consistent independence policies and procedures. These policies and procedures cover areas such as personal independence, firm financial independence, business relationships, post-employment relationships, partner rotation, and approval of audit and non-audit services. Ethics and independence policies are communicated through the issuance of bulletins to the audit practice and an annual training program. If applicable, amendments to the ethics and independence policies in the course of the year are communicated by e-mail alerts and included in regular bulletins. Independence Training and Confirmations

Non-Audit Services

Our firm has policies as to the scope of services that can be provided to audit clients which are consistent with the FRC's ES principles and applicable laws and regulations. KPMG International policies require the lead audit engagement partner to evaluate the threats arising from the provision of non-audit services, and the safeguards available to address those threats.

KPMG International's proprietary system, Sentinel™, facilitates compliance with these policies. Lead audit engagement partners are required to maintain group structures for their publicly traded and certain other audit clients and their affiliates in the system. Every engagement entered into by a KPMG member firm is required to be included in the system prior to starting work. The system enables lead audit engagement partners for entities for which group structures are maintained to review and approve, or deny, any proposed service for those entities worldwide.

In accordance with applicable auditor independence rules, none of our audit partners are compensated on their success in selling non-audit services to their audit clients.

Monitoring

KPMG International has an integrated monitoring program that covers all member firms to assess the relevance, adequacy, and effective operation of key quality control policies and procedures. This monitoring addresses both engagement delivery and KPMG International policies and procedures. The results and lessons from the programs are communicated within each member firm, and the overall results and lessons from the programs are considered and appropriate actions taken at regional and global levels. Our internal monitoring program also contributes to the assessment of whether each member firm's system of quality control has been appropriately designed, effectively implemented, and operates effectively.



Our monitoring procedures involve ongoing consideration of:

- compliance with KPMG International policies and procedures
- the effectiveness of training and other professional development activities
- compliance with applicable laws and regulation and member firms' standards, policies, and procedures.

Two KPMG International developed and administered inspection programs are conducted annually across the Audit, Tax, and Advisory functions, the Quality Performance Review (QPR) Program and the Risk Compliance Program (RCP).

Additionally, all member firms are covered by cross-functional Global Compliance Reviews (GCRs). These programs are designed by KPMG International and participation in them is a condition of ongoing membership of the KPMG network.

Quality Performance Reviews (QPRs)

The International QPR Program is the cornerstone of our efforts to monitor engagement quality, and one of our primary means of ensuring that member firms are collectively and consistently meeting KPMG International's requirements and applicable professional standards. The QPR Program assesses engagement level performance in the Audit, Tax, and Advisory functions and identifies opportunities to improve engagement quality.

All engagement partners are generally subject to selection for review at least once in a three-year cycle. The reviews are tailored to the relevant function, performed at a member firm level, overseen by a lead reviewer from outside the member firm, and are monitored regionally and globally.

We perform a root cause analysis for pervasive issues. Remedial action plans for all significant deficiencies noted are required at an engagement and member firm level. We disseminate our findings from the QPR Program to our professionals through written communications, internal training tools, and periodic partner, manager and staff meetings. These areas are also emphasized in subsequent inspection programs to gauge the extent of continuous improvement.

Lead audit engagement partners are notified of less than satisfactory engagement ratings on their respective cross-border engagements. Additionally, lead audit engagement partners of parent companies/head offices are notified when a subsidiary/affiliate of their client group is audited by a member firm where significant quality issues have been identified during the Audit QPR.

Risk Compliance Program (RCP)

The RCP is a member firm's annual self-assessment program. The objectives of the RCP are to monitor, assess, and document member firm-wide compliance with the system of quality control established through KPMG International's quality and risk management policies and applicable



legal and regulatory requirements as they relate to the delivery of professional services. The program is overseen and monitored regionally as well as globally.

Global Compliance Review (GCR) program

GCRs are performed by reviewers independent of the member firm, who report to Global Quality & Risk Management and are led by the Global Compliance Group. GCRs are carried out on member firms once in a three-year cycle. These reviews focus on significant governance, risk management, independence, and finance processes (including an assessment of the robustness of the firm's RCP).

In the event that a GCR identifies issues that require immediate or near-term attention, a follow-up review will be performed as appropriate. All three programs require action plans to address identified issues, with time lines, to be developed by the member firm, and these actions to improve performance are followed up at the regional and global level to ensure that the actions address the identified issues with the objective of continuous improvement.