KPMG

cutting through complexity

Report to those charged with governance (ISA 260) 2014/15

DRAFT

Nottingham City Council

September 2015

Contents

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. 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 Tony Crawley the engagement lead to the Authority, 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, Trevor Rees (on 0161 246 4000, or by email to trevor.rees@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, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

Section one

Introduction

This document summarises:

- **the key issues identified during our audit of the financial statements for the year ended 31 March 2015 for the Authority; and**
- **our assessment of the Authority's arrangements to secure value for money.**

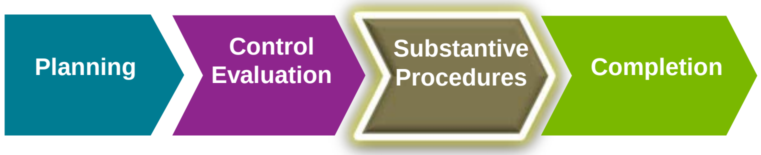
Scope of this report

This report summarises the key findings arising from:

- our audit work at Nottingham City Council ('the Authority') in relation to the Authority's 2014/15 financial statements; and
- the work to support our 2014/15 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

Financial statements

Our *External Audit Plan 2014/15*, presented to you in April 2015, set out the four stages of our financial statements audit process.



This report focuses on the third stage of the process: substantive procedures. Our on site work for this took place during August 2015.

We are now in the final phase of the audit, the completion stage.

VFM conclusion

Our *External Audit Plan 2014/15* explained our risk-based approach to VFM work. We have now substantially completed the work to support our 2014/15 VFM conclusion. This included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion; and
- considering the results of any relevant work by the Authority and other inspectorates and review agencies in relation to these risk areas.

Structure of this report

This report is structured as follows:

- Section two summarises the headline messages.
- Section three sets out our key findings from our audit work in relation to the 2014/15 financial statements of the Authority.
- Section four outlines our key findings from our work on the VFM conclusion.

Our key issues and recommendations are detailed 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 and Members for their continuing help and co-operation throughout our audit work.

Headlines

This table summarises the headline messages for the Authority.

Sections three and four of this report provide further details on each area.

Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2015. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.
Audit adjustments	Our audit identified one material audit adjustments within the financial statements which officers have agreed to adjust. This adjustment related to the presentation of Public Health expenditure on the face of the Comprehensive Income & Expenditure Statement. We also identified some control deficiencies which have led to us making a number of recommendations and these are detailed in Appendix 1. Our audit also identified some minor presentational adjustments to the financial statements presented for audit.
Key financial statements audit risks for the Authority	We identified the following key financial statements audit risk in our 14/15 External audit plan issued in March 2015. ■ Controls over transactions administered by EMSS ■ HRA – valuation of council housing ■ NET2 and its status ■ Accounting for Schools, following LAAP Bulletin 101 ■ New Company for administration of Revenues and Benefits ■ New banking arrangements We have worked with officers throughout the year to discuss how the Council have responded to these key risks. Our detailed findings are reported in section three of this report.
Accounts production and audit process	We received the accounts on 29 June 2015 The majority of working papers were received by us on the same day which was the first day of the audit site visit. On the whole, officers dealt with audit queries quickly and the majority of the audit process was completed within the planned timescales. Some key staff were absent during part of our site visit which delayed our review of pensions and payroll. We did experience a delay with queries raised with EMSS initially but after discussion, with the finance team, the majority of these were resolved promptly.

Headlines

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

Completion	At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas: ■ Resolution of our outstanding queries around non pay expenditure ■ Whole of Government Accounts ■ Group Consolidation Before we can issue our opinion we also 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 Authority's financial statements.
VFM conclusion and risk areas	We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2015.

Financial Statements
Proposed opinion and audit differences

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

We anticipated issuing an unqualified audit opinion in relation to the Authority's financial statements by 30 September 2015.

The wording of your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Audit Committee on 18 September 2015.

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 £19million. Audit differences below £0.950 million are not considered significant.

We identified one material misstatement which has been amended by staff which related to the presentation of Public Health expenditure on the face of the Comprehensive Income and Expenditure Statement.

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

In addition, we identified a small 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 2014/15 ('the Code')*. We understand that the Authority will be addressing these where significant.

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.

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

We have worked with the Authority 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 2014/15,* presented to you in March 2015, we identified the significant risks affecting the Authority and the 2014/15 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 Authority.

Significant audit risk	Issue	Findings
Controls over transactions administered by EMSS **Audit areas affected** ■ Mapping of the ledger –trial balance- to the accounts ■ Payroll, accounts payable and accounts receivable	That the issues raised in the ISA 260 for 2013/14 about controls within the East Midland's Shared Service have not been addressed sufficiently to provide assurance over the material accuracy of the financial statements.	We have undertaken procedures to check the progress on implementing Internal Audit's recommendations in respect of the shared service, We have also performed testing over key controls. Whilst we have identified some improvements, we have identified two specific control weaknesses, particularly in relation to non pay expenditure. As a consequence we have had to undertake some additional substantive testing to provide sufficient assurance that these weaknesses have not led to a material misstatement in the accounts (this work is ongoing). We have made recommendations in Appendix 1.

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

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

This section sets out our detailed findings on those risks

Significant audit risk	Issue	Findings
HRA valuation **Audit areas affected** ■ PPE note and values of HRA valuation	The HRA stock represents a very large balance in the PPE and a revaluation may have a material impact on this balance.	We have reviewed the valuation and confirmed that the changes have been processed in line with the guidance. As part of this work we compared the movements highlighted by the valuer with independent indices which give a regional and national indication of housing values. These independent indices suggested a movement between 4.3% and 4.8%. The average movement for Nottingham City Council's valuation was an average of 7.18%. This difference was discussed with the Capital Accountant and the Estates Surveyor who demonstrated that they had queried the difference with the Valuer. The main reason for the above average increase is that the ongoing Decent Homes work has improved the housing stock and had an associated impact on the value of the property. We consider that these explanations provided are reasonable.

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

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

This section sets out our detailed findings on those risks

Significant audit risk	Issue	Findings
NET2 **Audit areas affected** ■ PFI disclosures ■ Financial planning for PFI scheme	The NET2 tram extension project is a major capital project for the council. As a PFI scheme the accounting related disclosures are complex and so there is an inherent risk of material error related to the scheme. We planned to review the current status and financial modelling.	We have discussed with officers the status of NET2. Due to delays on the scheme, this means that financial close has not been reached. This will be an issue for the 2015-16 financial year. However, we have reviewed the arrangements for an increase in provisions of approximately £22m which represents the estimation of compensation agreements reached with businesses and land owners impacted by NET2. There are no matters to report.
Accounting for schools **Audit areas affected** ■ School Accounting	A new LAAP (Local Authority Accounting Panel) bulletin (LAAP 101) has been issued in relation to the accounting treatment for school assets with the council's balance sheet.	We discussed the arrangements for schools with the capital accountant and have reviewed the accounting treatment. This resulted in one school being brought on balance sheet as an in-year adjustment. We confirmed this is in line with the Code.

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

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

This section sets out our detailed findings on those risks

Significant audit risk		Issue	Findings
New Company for Revenues and Benefits	**Audit areas affected** ■ Payroll ■ Group Accounts	A new company was created for the administration of revenues and benefits. A number of staff transferred.	We reviewed the arrangements for the company and considered its treatment as part of the group accounting treatment. There are no matters to report.
New bank accounts	**Audit areas affected** ■ Cash	The Authority transferred its banking arrangements during the year.	We reviewed the transfer process and confirmed year end balance to third party confirmations. There are no matters to report.

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

In our *External Audit Plan 2014/15* 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. Our work in relation to approval of non-pay expenditure has flagged one instance of a control being overridden – we have raised an associated recommendation in Appendix 1.
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 2014/15 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.

Financial Statements (cont.)
Accounts production and audit process

Further improvements need to be made to the Authority's accounts production.

On the whole, officers dealt with audit queries quickly and the majority of the audit process was completed within the planned timescales.

The Authority has yet to fully implement the recommendations in our *ISA 260 Report 2013/14.*

Accounts production and audit process

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

Element	Commentary
Accounting practices and financial reporting	The Authority has made some progress in strengthening the preparation of accounts process but the absence of key staff meant delays. EMSS payroll did not respond to queries promptly until intervention by senior staff. Our testing of controls has highlighted some instances of a control not operating as designed in relation to non-pay expenditure. Further work is ongoing to establish whether there is a wider impact on the financial statements in relation to these issues and we have raised a recommendation in Appendix 1.
Completeness of draft accounts	We received a complete set of draft accounts on 29 June 2015 which was the first day of our planned site visit. However, during our time on site, some key officers were on annual leave which meant postponing some work on significant areas, for example, payroll and pensions.
Quality of supporting working papers	We issued our *Accounts Audit Protocol* including our required working papers for the audit on 10 February 2015. The quality of working papers provided was good but not all were available on day one of our audit.

Response to audit queries

The majority of officers responded to audit queries promptly although we did experience some initial delay in receiving responses from EMSS to payroll queries however once this was flagged to the finance team the information was made available promptly.

Prior year recommendations

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

The Authority has yet to fully implement the recommendation in our *ISA 260 Report 2013/14*.

Appendix 2 provides further details.

Financial Statements (cont.) Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority'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 Nottingham City Council and for the year ending 31 March 2015, we confirm that there were no relationships between KPMG LLP and Nottingham City Council and its senior management 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 senior accountant for presentation to the Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

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.

VFM conclusion

Our VFM conclusion considers how the Authority secures financial resilience and challenges how it secures economy, efficiency and effectiveness.

We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Background

Auditors are required to give their statutory VFM conclusion based on two criteria specified by the Audit Commission. These consider whether the Authority has proper arrangements in place for:

- securing financial resilience: looking at the Authority's financial governance, financial planning and financial control processes; and
- challenging how it secures economy, efficiency and effectiveness: looking at how the Authority is prioritising resources and improving efficiency and productivity.

We follow a risk based approach to target audit effort on the areas of greatest audit risk. We consider the arrangements put in place by the Authority to mitigate these risks and plan our work accordingly.

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

Work completed

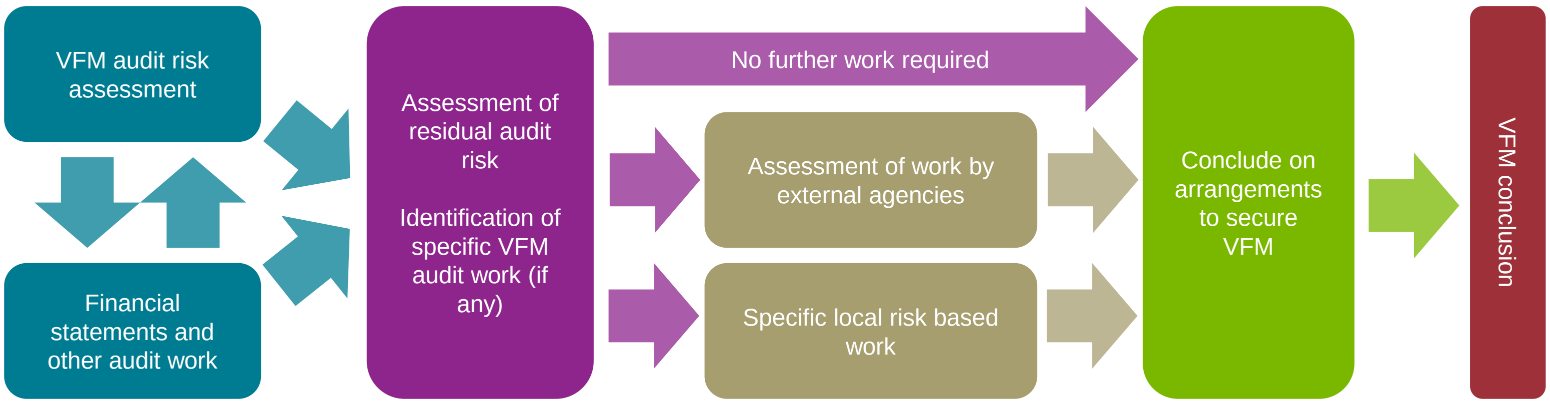
We performed a risk assessment earlier in the year and have reviewed this throughout the year.

We have not identified any significant risks to our VFM conclusion and therefore have not completed any additional work.

Conclusion

We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

VFM criterion	Met
Securing financial resilience	✓
Securing economy, efficiency and effectiveness	✓



Specific VFM risks

We identified a single specific VFM risk.

We are satisfied that internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to this risk area is adequate.

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 Authority'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;

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

We concluded that we did not need to carry out additional work for this risk as there was sufficient relevant work that had been completed by the Authority, inspectorates and review agencies in relation to this risk area.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
	The Council continues to face the requirement to reduce its spend as Central Government funding reduces. The Medium Term Financial Plan for 2014/15 to 2016/17 assumed a reduction in the spending power of the Council of 5.1% in 2014/15 and 5.3% in 2015/16. The plan forecast a reduction in Revenue Support Grant of £21.9m in 2014/15 and a further £28.2m in 2015/16. The Council set a balanced budget for 2014/15, incorporating £22.6m of savings with a further requirement for £24.8m of savings planned for 2015/16. This is relevant to the financial resilience criteria.	The Council has maintained its good track record of delivering planned cost reduction savings. In 2014/15 the Council delivered £12.7m of its original £14.9m targeted cost reductions finding the remaining £2.2m from alternative schemes. This new 'Strategic Choices' service based cost reduction approach involving front line staff has therefore worked well and underpins the budget plans for 2015/16. The Council has set a balanced budget for 2015/16, incorporating a further £23.5m of agreed cost reductions. Since then the Council has been informed that it must also manage a further £2m in year reduction in Public Health Funding. It is also working through the impact on HRA business plans of the 1% per annum rent reductions over the next four years. An update report on in-year progress has yet to go the Executive. The funding gap for 2016/17 is currently forecast to be at least £23m plus the impact of budget pressures although work has already started to identify how this gap can be met. Continuing to deliver significant cost reductions year on year is clearly demanding, and will require further difficult decisions along with close monitoring of the results, especially the impact on key services. **Specific risk based work required: No**

Appendix 1: Key issues and recommendations 2014-15

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

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	❶	**Authorisation of expenditure** As part of our controls testing in respect of non-pay expenditure, we tested 75 items; 25 of each type of payment - purchase order invoice, non-purchase order invoice, request for payment. We identified two items that had not been authorised appropriately: • A request for payment totalling £117,000 had been authorised by an employee with an authorisation limit of £100,000. The expenditure was legitimate. We are advised that the system is to be changed so that this type of request for payment would go through workflow in the future, allowing authorisation only by officers with appropriate authority levels. • The second item was a non-purchase order invoice where no authority was provided in workflow despite the item being redirected to several individuals with increasing levels of seniority. The item was paid as it is possible to override the workflow function. We did not identify any other examples of this. We are currently undertaking further testing as we seek to obtain sufficient assurance that these weaknesses have not led to a material misstatement in the accounts. Recommendation The Council should put in place measures to prevent payments being made without appropriate authorisation.	The colleagues involved have been reminded of their authorisation limits. The management structure and processes within EMSS have been reviewed and changed during the past year. The practice of overriding the approval process is no longer sanctioned by senior management.

Appendix 1: Key issues and recommendations 2014-15

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

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
2	❷	<u>Income and Expenditure overstated</u> Detailed testing of non-pay expenditure identified that Public Health Income and Expenditure was overstated by £20.8m. This was due to a journal being incorrectly posted (income was posted to an expenditure code and vice versa). The error was identified prior to closedown but had not been corrected prior to the submission of accounts to the auditors. This is a material misstatement. <u>Recommendation</u> The finance team should undertake a detailed financial review of the financial statements prior to issue so that errors are identified and corrected prior to the submission of the accounts for audit.	The relevant checks will be automated and undertaken earlier during the production of the Statement of Accounts for 2015/16.

Appendix 1: Key issues and recommendations 2014-15

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

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
3	❶	**Journals** As part of our audit approach we routinely test journals, throughout the year and journals created for the closedown period. Our testing identified a journal with a value of £47 billion. This journal had to be created to correct a posting error resulting in a misstatement of £47 billion. Best practice is that a posting error of such a large and unusual value should not be possible and that a ledger system should flag and prevent such an entry being posted. Recommendation The Council should review the ledger system to identify if it is possible to input parameters beyond which postings cannot be made.	A review of the parameters will be undertaken. Person Responsible: Jeff Abbott Due Date: 31/3/16

Appendix 1: Key issues and recommendations 2014-15

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

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
4	❶	Control weaknesses in EMSS over payroll Throughout work on payroll we identified that EMSS do not undertake a payroll reconciliation for Nottingham City Council although they do this for Leicester City Council. Exception reports, one of the outputs from payroll are not checked by EMSS. We expect that the responsibilities of EMSS should be set out in an Service Level Agreement to enable both parties to be clear what tasks should be carried out by each party. Recommendation Nottingham City Council and East Midlands Shared Service should set up a Service Level Agreement as soon as possible.	Responsibility for the reconciliations has been passed over to EMSS. An SLA with EMSS is in the process of being set up. Person Responsible: Jeff Abbott Due Date: 31/12/15

Appendix 2: Follow up of prior year recommendations

The Authority has not implemented all of the recommendations in our *ISA 260 Report 2013/14.*

New recommendations have been made in Appendix 1

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2013/14* and re-iterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	1
Implemented in year or superseded	0
Remain outstanding (re-iterated in Appendix 1)	1

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	Officer responsible and due date	Status as at August 2015
1	❶	**Control weaknesses at EMSS** As reported to you by Internal Audit there are weaknesses in the operation of controls by EMSS in the following systems: • Payroll • Accounts payable • Accounts receivable We have reviewed the controls at EMSS and have found that though no material impact on the financial statements has occurred, there are still weaknesses to be addressed.		Not fully implemented in 2014/15; a Service Level Agreement needs to be put in place with EMSS so that responsibilities are clear. Nottingham City Council need to take responsibility to address control weaknesses.

Appendix 3: Audit differences

This appendix sets out the significant / non-trivial audit differences.

It is our understanding that all of these will be adjusted.

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 Audit Committee. 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.

Corrected audit differences

The following table sets out the significant audit differences identified by our audit of Nottingham City Council's financial statements for the year ended 31 March 2015. This amendment has been adjusted for in the final version of the financial statements.

	Impact					
No.	**Income and Expenditure Statement**	**Movement in Reserves Statement**	**Assets**	**Liabilities**	**Reserves**	**Basis of audit difference**
1	Dr income £20.8m Cr expenditure £20.8m					Journal incorrectly input in relation to Public Health Expenditure leading to both income and expenditure being overstated by a material amount. As the net impact of this error is nil there is no overall impact on the general fund.
	Dr/cr £0	**Dr/Cr £0**	**Dr/Cr £0**	**Dr/Cr £0**	**Cr £0k**	**Total impact of adjustments**

Appendix 4: 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 Authority.

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 Audit Committee.

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.

Appendix 4: 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 Authority'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 Nottingham City Council for the financial year ending 31 March 2015, we confirm that there were no relationships between KPMG LLP and Nottingham City Council, 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.

Appendix 5: Materiality and reporting of audit differences

For 2014/15 our materiality is £19 million for the Authority's accounts.

We have reported all audit differences over £14.250 million for the Authority's accounts.

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 reassessed materiality for the Authority at the start of the final accounts audit following receipt of the 2014/15 accounts, which confirmed the actual gross expenditure incurred by the Authority.

Materiality for the Authority's accounts was set at £19m which equates to around 2% percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the General Purposes and Audit Committee

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 General Purposes and Audit Committee 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 Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £950k for the Authority.

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

Appendix 6: 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. Tony Crawley 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 Audit Commission'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 Authority'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 Audit Commission'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.

Appendix 6: 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 behaviors in the performance of effective and efficient audits. The key behaviors 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 2014/2015) showed that we are meeting the overall audit quality and regulatory compliance requirements.

cutting through complexity™