



# External Audit Plan 2015/2016

Nottingham City Council

February 2016

## Financial Statement Audit



There are no significant changes to the Code of Practice on Local Authority Accounting in 2015/16, which provides stability in terms of the accounting standards the Authority need to comply with.

### Materiality

Materiality for planning purposes has been based on last year's expenditure and set at **£12 million**.

We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance and this has been set at **£0.6 million**.

### Significant risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error have been identified as:

- **Management override of controls;**
- **Net2 – accounting and associated PFI disclosures; and**
- **Controls over transactions**

### Other areas of audit focus

Those risks we consider could potentially develop into a significant risk and therefore worthy of audit understanding have been identified as:

- **Consolidated Group Accounts**
- **MRP Calculation**
- **PPE Valuation (including IFRS 13 Surplus Assets)**

**See pages 3 to 5 for more details.**

## Value for Money Arrangements work



The National Audit Office has issued new guidance for the VFM audit which applies from the 2015/16 audit year. The approach is broadly similar in concept to the previous VFM audit regime, but there are some notable changes:

- There is a new overall criterion on which the auditor's VFM conclusion is based; and
- This overall criterion is supported by three new sub-criteria.

Our risk assessment regarding your arrangements to secure value for money have identified the following VFM significant risks:

- **New possible group entity - Adducere**
- **Delivery of Savings Plans**
- **Better Care Fund**

**See pages 6 to 9 for more details.**

## Logistics



Our team is:

- Tony Crawley – Director
- Richard Walton – Senior Manager
- Thomas Tandy – Manager
- Oliver Stidwell – In-charge

More details are on **page 12**.

Our work will be completed in four phases from December 2015 to September 2016 and our key deliverables are this Audit Plan and a Report to those charged with Governance as outlined on **page 11**.

Our fee for the audit is £172,118 (£229,490 2014/2015) see **page 10**.

## Background and Statutory responsibilities

This document supplements our Audit Fee Letter 2015/16 presented to you in April 2015, which also sets out details of our appointment by Public Sector Audit Appointments Ltd (PSAA).

Our statutory responsibilities and powers are set out in the Local Audit and Accountability Act 2014 and the National Audit Office's Code of Audit Practice.

Our audit has two key objectives, requiring us to audit/review and report on your:

- *Financial statements (including the Annual Governance Statement):* Providing an opinion on your accounts; and
- *Use of resources:* Concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the value for money conclusion).

The audit planning process and risk assessment is an on-going process and the assessment and fees in this plan will be kept under review and updated if necessary.

## Acknowledgements

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

## Financial Statements Audit

Our financial statements audit work follows a four stage audit process which is identified below. Appendix 1 provides more detail on the activities that this includes. This report concentrates on the Financial Statements Audit Planning stage of the Financial Statements Audit.



## Value for Money Arrangements Work

Our Value for Money (VFM) Arrangements Work follows a five stage process which is identified below. Page 6 provides more detail on the activities that this includes. This report concentrates on explaining the VFM approach for the 2015/16 [and the findings of our VFM risk assessment].



## Financial Statements Audit Planning

Our planning work takes place during December 2015 to February 2016. This involves the following key aspects:

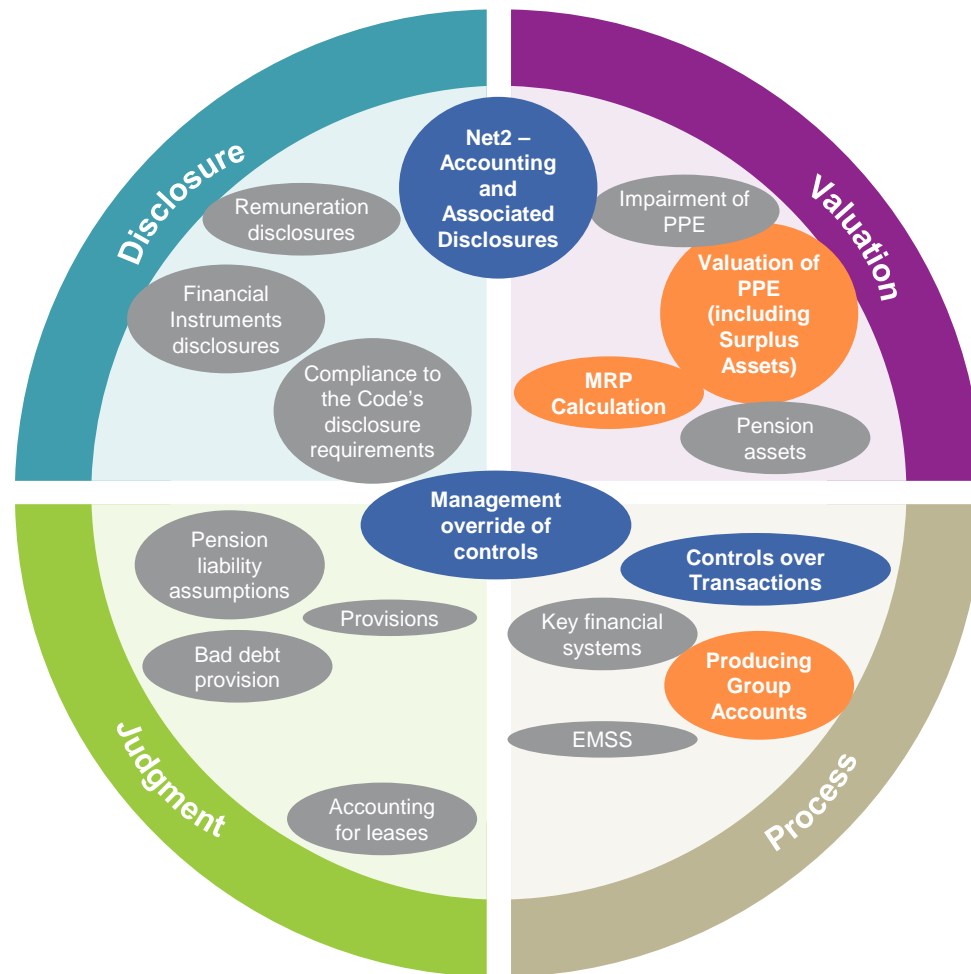
- Risk assessment;
- Determining our materiality level; and
- Issuing this audit plan to communicate our audit strategy.

### Risk assessment

Professional standards require us to consider two standard risks for all organisations. We are not elaborating on these standard risks in this plan but consider them as a matter of course in our audit and will include any findings arising from our work in our ISA 260 Report.

- Management override of controls – Management is typically in a powerful position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we carry 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.
- Fraudulent revenue recognition – We do not consider this to be a significant risk for local authorities as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures.

The diagram opposite identifies, significant risks and other areas of audit focus, which we expand on overleaf. The diagram also identifies a range of other areas considered by our audit approach.



- Keys:
- Significant risk
  - Other area of audit focus
  - Example other areas considered by our approach



## Significant Audit Risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error.

### Management override of Controls

- We flagged an issue in the ISA260 last year regarding management override of controls. This included instances of non-compliance with the approval limits for non-pay expenditure, as highlighted by our controls testing in 2014-15.
- During our testing this year we will review the steps taken by the Authority to address the issues raised in the ISA 260 through discussions with the Authority's officers and internal audit.
- We will perform controls testing over non-pay expenditure as part of our interim audit visit, focussing on transactions processed through the accounts payable system and other material expenditure systems, including the Abacus system (used to process payments related to Adult Social Care).
- Management override will be considered during all areas of testing with particular focus over journals and non pay expenditure.

### Net2

- The Net2 Tram service has been completed during the year. This means there will be complex accounting entries relating to bringing the assets into operation, along with required PFI disclosures which need to comply with the CIPFA Code and accounting standards.
- As part of our interim visit we will review the draft accounting treatment for NET2 and respective disclosures.

### Controls over Transactions

- The Authority uses the East Midlands Shared Service team to process including accounts payable and payroll, where it was identified in the prior year some inconsistencies and weakness over key controls.
- We will review the SLAs and perform procedures to check that the key controls are operating effectively.

## Other areas of audit focus

Those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding.

### PPE Valuation & IFRS 13 Surplus Assets

- Due to the inherent risk associated with the estimation of assets and the implementation of IFRS 13 which require surplus assets to be measured at fair value for 2015/16, we consider this to be a significant risk.
- We will undertake the following procedures over this significant risk:
  - Review the terms of engagement with the valuer to ensure compliance with the Authority's accounting policies.
  - Review the revaluation basis and consider its appropriateness with CIPFA Code of Practice and the underlying IFRS accounting standards.
  - Undertake appropriate work to understand the basis upon which any impairments have been calculated.

### Group Accounts

- Due to the group structure, the Authority will need to ensure its group accounts are complete and intra group transactions correctly identified and removed.
- We will review proposed consolidation procedures as part of our interim work.

### MRP Calculation

- The Authority is currently in the process of updating its policy in regard to MRP (Minimum Revenue Provision).
- We review the new policy and the process of approval to confirm that the Authority has obtained the appropriate legal advice and had sufficient regard to the regulations in place.



## Materiality

We are required to plan our audit to determine with reasonable confidence whether or not the financial statements are free from material misstatement. An omission or misstatement is regarded as material if it would reasonably influence the user of financial statements. This therefore involves an assessment of the qualitative and quantitative nature of omissions and misstatements.

Generally, we would not consider differences in opinion in respect of areas of judgement to represent 'misstatements' unless the application of that judgement results in a financial amount falling outside of a range which we consider to be acceptable.

Materiality for planning purposes has been set at £12 million for the Authority's standalone and group accounts. This equates to 1.1 percent of gross expenditure.

We design our procedures to detect errors in specific accounts at a lower level of precision.

## Reporting to the 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 Audit Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work.

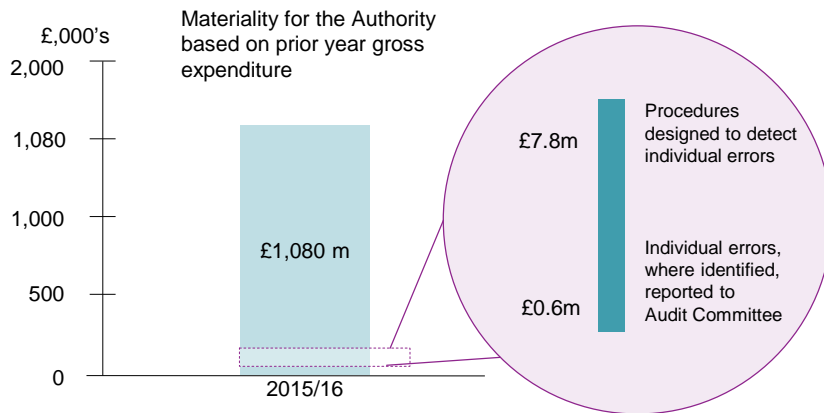
Under ISA 260(UK&I) 'Communication with those charged with governance', we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK&I) defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

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 £0.6 million.

If 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.

## Group audit

The expectation is still that individually none of the subsidiaries constitute a significant component.



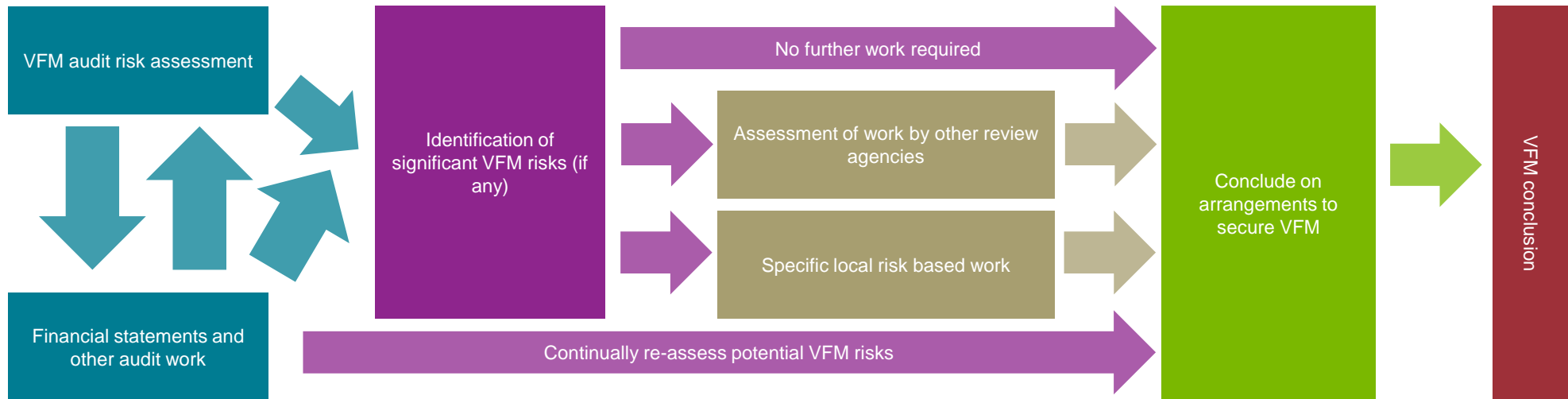
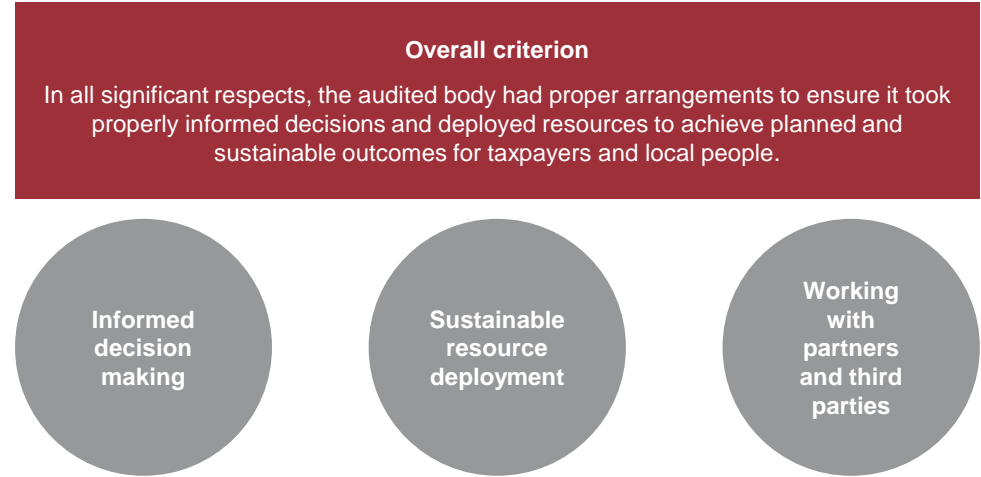


## Background to approach to VFM work

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

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

The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria. These sub-criteria provide a focus to our VFM work at the Authority. The diagram to the right shows the details of this criteria.





VFM audit stage	Audit approach
VFM audit risk assessment	<p>We consider the relevance and significance of the potential business risks faced by all local authorities, and other risks that apply specifically to the Authority. These are the significant operational and financial risks in achieving statutory functions and objectives, which are relevant to auditors' responsibilities under the <i>Code of Audit Practice</i>.</p> <p>In doing so we consider:</p> <ul style="list-style-type: none"> <li>■ The Authority's own assessment of the risks it faces, and its arrangements to manage and address its risks;</li> <li>■ Information from the Public Sector Auditor Appointments Limited VFM profile tool;</li> <li>■ Evidence gained from previous audit work, including the response to that work; and</li> <li>■ The work of other inspectorates and review agencies.</li> </ul>
Linkages with financial statements and other audit work	<p>There is a degree of overlap between the work we do as part of the VFM audit and our financial statements audit. For example, our financial statements audit includes an assessment and testing of the Authority's organisational control environment, including the Authority's financial management and governance arrangements, many aspects of which are relevant to our VFM audit responsibilities.</p> <p>We have always sought to avoid duplication of audit effort by integrating our financial statements and VFM work, and this will continue. We will therefore draw upon relevant aspects of our financial statements audit work to inform the VFM audit.</p>
Identification of significant risks	<p>The Code identifies a matter as significant '<i>if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public. Significance has both qualitative and quantitative aspects.</i>'</p> <p>If we identify significant VFM risks, then we will highlight the risk to the Authority and consider the most appropriate audit response in each case, including:</p> <ul style="list-style-type: none"> <li>■ Considering the results of work by the Authority, inspectorates and other review agencies; and</li> <li>■ Carrying out local risk-based work to form a view on the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources.</li> </ul>





VFM audit stage	Audit approach
<p>Assessment of work by other review agencies</p> <p>and</p> <p>Delivery of local risk based work</p>	<p>Depending on the nature of the significant VFM risk identified, we may be able to draw on the work of other inspectorates, review agencies and other relevant bodies to provide us with the necessary evidence to reach our conclusion on the risk.</p> <p>If such evidence is not available, we will instead need to consider what additional work we will be required to undertake to satisfy ourselves that we have reasonable evidence to support the conclusion that we will draw. Such work may include:</p> <ul style="list-style-type: none"> <li>■ Meeting with senior managers across the Authority;</li> <li>■ Review of minutes and internal reports;</li> <li>■ Examination of financial models for reasonableness, using our own experience and benchmarking data from within and without the sector.</li> </ul>
<p>Concluding on VFM arrangements</p>	<p>At the conclusion of the VFM audit we will consider the results of the work undertaken and assess the assurance obtained against each of the VFM themes regarding the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources.</p> <p>If any issues are identified that may be significant to this assessment, and in particular if there are issues that indicate we may need to consider qualifying our VFM conclusion, we will discuss these with management as soon as possible. Such issues will also be considered more widely as part of KPMG's quality control processes, to help ensure the consistency of auditors' decisions.</p>
<p>Reporting</p>	<p>On the following page, we report the results of our initial risk assessment.</p> <p>We will also update our assessment throughout the year should any issues present themselves and report against these in our ISA260.</p> <p>We will report on the results of the VFM audit through our ISA 260 Report. This will summarise any specific matters arising, and the basis for our overall conclusion.</p> <p>The key output from the work will be the VFM conclusion (i.e. our opinion on the Authority's arrangements for securing VFM), which forms part of our audit report.</p>



## Significant VFM Risks

Those risks requiring specific audit attention and procedures to address the likelihood that proper arrangements are not in place to deliver value for money.

### Significant Risk 1

#### ■ New possible group entity - Adducere

The Authority is in the process of setting up a new joint venture 'Adducere' to deliver the construction of a new building within the City. This joint venture has an innovative structure which has not been used by the Authority before.

- The proposed structure will be reviewed by KPMG's leasing specialist in KPMG's tax team to consider the arrangements in place and flag and risk areas that the Authority should consider further.

### Significant Risk 2

#### ■ Delivery of Saving Plans

As reported in the Authority's medium term financial plan in February 2015, central government's settlement funding for the Authority has reduced by £69m since 2013/14, however further strong financial challenges lie ahead. The Authority forecasts further savings will need to be found as the Authority faces further expenditure pressures and a continued reduction in resources including a savings requirement of £20.5m in 2016-17. Therefore we consider this as a significant risk.

- We will undertake the following procedures over this significant risk:
  - Review the delivery of the Authority's savings programme.
  - Review the delivery of the saving plans including any actions taken by the Authority where savings are achieved in line with the plan.
  - Evaluate the arrangements the Authority have in place in identifying further savings for future years.

### Significant Risk 3

#### ■ Better Care Fund

In 2015/16 the Authority entered into Section 75 agreement with Nottingham City Clinical Commissioning Group to pool funds of £23m to implement the local Better Care Fund. The implementation of the Better Care Fund drives integration of services to improve outcomes for the patient and public as well as delivery efficiencies and effectively manages limited resources during challenging times. We consider this a significant risk as the Better Care Fund is in its early stages and therefore there are risks associated with the delivery of improved health and social care in Nottingham and achieving significant savings.

- We will undertake the following procedures over this significant risk:
  - Review the Better Care Plan and progress made against the plan.
  - Review the delivery of the services against targets and consider any actions taken by the Authority where delivery is under performing significantly.
  - Review the savings achieved are in line with those planned and consider how the Authority will fund any savings which are not achieved.

### Whole of government accounts (WGA)

We are required to review your WGA consolidation and undertake the work specified under the approach that is agreed with HM Treasury and the National Audit Office. Deadlines for production of the pack and the specified approach for 2015/16 have not yet been confirmed.

### Elector challenge

The Local Audit and Accountability Act 2014 gives electors certain rights. These are:

- The right to inspect the accounts;
- The right to ask the auditor questions about the accounts; and
- The right to object to the accounts.

As a result of these rights, in particular the right to object to the accounts, we may need to undertake additional work to form our decision on the elector's objection. The additional work could range from a small piece of work where we interview an officer and review evidence to form our decision, to a more detailed piece of work, where we have to interview a range of officers, review significant amounts of evidence and seek legal representations on the issues raised.

The costs incurred in responding to specific questions or objections raised by electors is not part of the fee. This work will be charged in accordance with the PSAA's fee scales.

### Our audit team

Our audit team will be led by Tony Crawley. Appendix 2 provides more details on specific roles and contact details of the team.

### Reporting and communication

Reporting is a key part of the audit process, not only in communicating the audit findings for the year, but also in ensuring the audit team are accountable to you in addressing the issues identified as part of the audit strategy. Throughout the year we will communicate with you through meetings with the finance team and the Audit Committee. Our communication outputs are included in Appendix 1.

### Independence and Objectivity

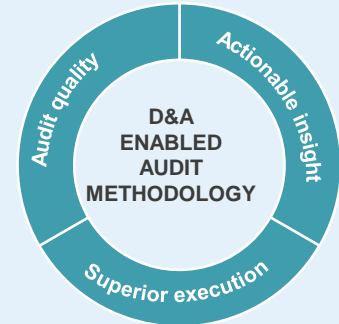
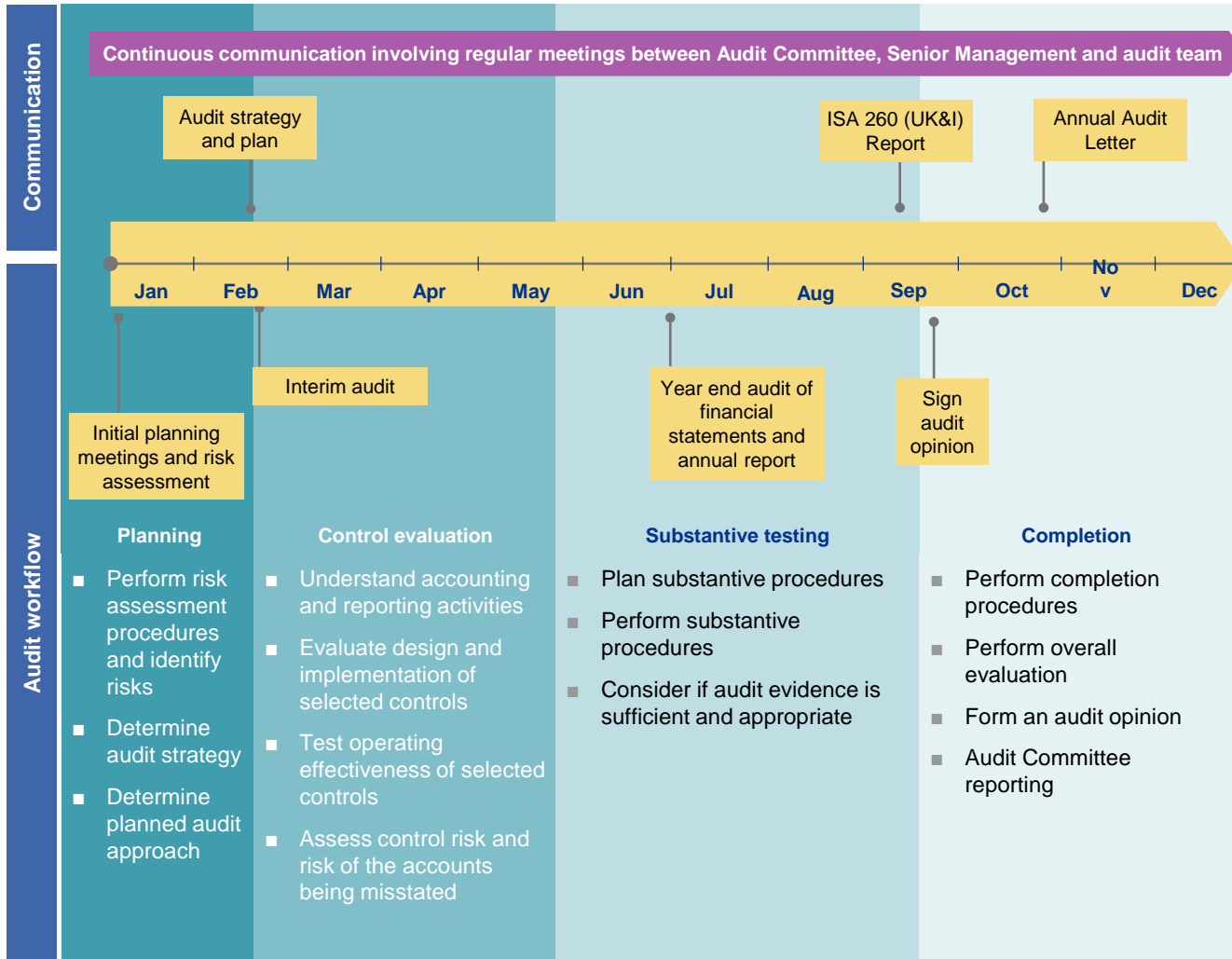
Auditors are also required to be independent and objective. Appendix 3 provides more details of our confirmation of independence and objectivity.

### Audit fee

*Our Audit Fee Letter 2015/2016* presented to you in April 2015 first set out our fees for the 2015/2016 audit. This letter also sets out our assumptions. We have not considered it necessary to make any changes to the agreed fees at this stage.

The planned audit fee for 2015/16 is £172,118. This is a reduction in audit fee, compared to 2014/2015, of 25% (£229,490).

Our audit fee includes our work on the VFM conclusion and our audit of the Authority's financial statements.



### Driving more value from the audit through data and analytics

Technology is embedded throughout our audit approach to deliver a high quality audit opinion. Use of Data and Analytics (D&A) to analyse large populations of transactions in order to identify key areas for our audit focus is just one element. We strive to deliver new quality insight into your operations that enhances our and your preparedness and improves your collective 'business intelligence.' Data and Analytics allows us to:

- Obtain greater understanding of your processes, to automatically extract control configurations and to obtain higher levels assurance.
- Focus manual procedures on key areas of risk and on transactional exceptions.
- Identify data patterns and the root cause of issues to increase forward-looking insight.

**We anticipate using data and analytics in our work around key areas such as accounts payable and journals. We also expect to provide insights from our analysis of these tranches of data in our reporting to add further value from our audit.**



Your audit team has been drawn from our specialist public sector assurance department.



<b>Name</b>	Tony Crawley
<b>Position</b>	Director
	<p>'My role is to lead our team and ensure the delivery of a high quality, valued added external audit opinion.</p> <p>I will be the main point of contact for the Audit Committee and Chief Executive.'</p>

**Tony Crawley**

Director

Telephone: +44 116 2566067

Email: Tony.Crawley@KPMG.co.uk



<b>Name</b>	Richard Walton
<b>Position</b>	Senior Manager
	<p>'I provide quality assurance for the audit work and specifically any technical accounting and risk areas.</p> <p>I will work closely with Tony and the team to ensure we add value.</p> <p>I will liaise with the Director of Finance and other Executive Directors.'</p>

**Richard Walton**

Senior Manager

Telephone: +44 115 9454471

Email: Richard.Walton@KPMG.co.uk



<b>Name</b>	Thomas Tandy
<b>Position</b>	Manager
	<p>'I will work with Richard and Oliver to co-ordinate the audit process and ensure that the day to day running of the audit runs smoothly.'</p>

**Thomas Tandy**

Manager

Telephone: +44 115 9454480

Email: Thomas.Tandy@KPMG.co.uk



<b>Name</b>	Oliver Stidwell
<b>Position</b>	On-site In-charge
	<p>'I will oversee the audit fieldwork, including the accounts; coordination of work completed by KGS and audit assistants; coordination of work of specialists and advisors.'</p>

**Oliver Stidwell**

On-site In-charge

Telephone: +44 121 6096076

Email: Oliver.Stidwell@KPMG.co.uk

### Independence and objectivity

Professional standards require auditors to communicate to those charged with governance, at least annually, all relationships that may bear on the firm's independence and the objectivity of the audit engagement partner and audit staff. The standards also place requirements on auditors in relation to integrity, objectivity and independence.

The standards define 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case this is the Audit Committee.

KPMG LLP is committed to being and being seen to be independent. APB Ethical Standard 1 Integrity, Objectivity and Independence requires us to communicate to you in writing all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Engagement Lead and the audit team.

Further to this auditors are required by the National Audit Office's Code of Audit Practice to:

- Carry out their work with integrity, independence and objectivity;
- Be transparent and report publicly as required;
- Be professional and proportional in conducting work;
- Be mindful of the activities of inspectorates to prevent duplication;
- Take a constructive and positive approach to their work;
- Comply with data statutory and other relevant requirements relating to the security, transfer, holding, disclosure and disposal of information.

PSAA's Terms of Appointment includes several references to arrangements designed to support and reinforce the requirements relating to independence, which auditors must comply with. These are as follows:

- Auditors and senior members of their staff who are directly involved in the management, supervision or delivery of PSAA audit work should not take part in political activity.

- No member or employee of the firm should accept or hold an appointment as a member of an audited body whose auditor is, or is proposed to be, from the same firm. In addition, no member or employee of the firm should accept or hold such appointments at related bodies, such as those linked to the audited body through a strategic partnership.
- Audit staff are expected not to accept appointments as Governors at certain types of schools within the local authority.
- Auditors and their staff should not be employed in any capacity (whether paid or unpaid) by an audited body or other organisation providing services to an audited body whilst being employed by the firm.
- Auditors appointed by the PSAA should not accept engagements which involve commenting on the performance of other PSAA auditors on PSAA work without first consulting PSAA.
- Auditors are expected to comply with the Terms of Appointment policy for the Engagement Lead to be changed on a periodic basis.
- Audit suppliers are required to obtain the PSAA's written approval prior to changing any Engagement Lead in respect of each audited body.
- Certain other staff changes or appointments require positive action to be taken by Firms as set out in the Terms of Appointment.

### Confirmation statement

We confirm that as of February 2016 in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Engagement Lead and audit team is not impaired.



© 2016 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name, logo and “cutting through complexity” are registered trademarks or trademarks of KPMG International.

Produced by Create Graphics/Document number: CRT053550A

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. We draw your attention to the Statement of Responsibilities of auditors and audited bodies, which is available on Public Sector Audit Appointment's website ([www.psa.co.uk](http://www.psa.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 [...], 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, Andrew Sayers, by email to [Andrew.Sayers@kpmg.co.uk](mailto:Andrew.Sayers@kpmg.co.uk). After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing [generalenquiries@psaa.co.uk](mailto: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.