External Audit ISA260 Report 2017/18

Nottingham City Council

—

July 2018

Summary for Audit Committee

This document summarises the key findings in relation to our 2017-18 external audit at Nottingham City Council ('the Authority').

This report covers both our on-site work which was completed in March and June to July 2018 on the Authority's significant risk areas, as well as other areas of your financial statements, and the control environment in place to support the production of timely and accurate financial statements.

Organisational and IT control environment

We have identified no significant issues with the Authority's organisational and IT control environment and consider that the overall arrangements that have been put in place are reasonable.

As part of our testing of General Ledger IT Controls, we have made five recommendations regarding the use of generic user accounts, timely removal of leavers and user access reviews.

Controls over key financial systems

Based on our testing the controls over the majority of the key financial systems are sound.

As part of our testing over journals we have a made a recommendation that the Authority considers increasing the robustness of journal controls as part of the Fit For the Future project.

Accounts production

The Authority incorporated a number of measures into its closedown plan to further improve the project management of this complex process.

This included significant preparatory work in regards to ensuring the wider group was lined up to provide both draft and audited accounts to support the production of the Authority's Group accounts. The Authority recognised the additional pressures which the earlier closedown brought and we engaged with officers in the period leading up to the year end in order to proactively address issues as they emerged.

We consider that the overall process for the preparation of your financial statements is sound, we also consider the Authority's accounting practices appropriate.

Financial statements

Subject to all outstanding queries being resolved to our satisfaction we anticipate issuing an unqualified audit opinion on the Authority's financial statements before the deadline of 31 July 2018.

Based upon our initial assessment of risks to the financial statements (as reported to you in our *External Audit Plan 2017/18* and updated during our audit) we identified the following significant risks (excluding those mandated by International Standards on Auditing):

- **Valuation of PPE**
- **Pensions Liabilities**
- **Faster Close**

As part of our audit testing, we have identified one non-material audit adjustment. There are no unadjusted audit differences. Based on our work, we have raised 13 recommendations. Details of our recommendations can be found in Appendix 1.

Summary for Audit Committee (cont.)

Value for money arrangements	We have completed our risk-based work to consider whether in all significant respects the Authority has proper arrangements to ensure it has taken properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We have commented on the significant challenges facing the Authority and the need for action to address them. **We therefore anticipate issuing unqualified value for money opinion.** We set out our assessment of those areas requiring additional risk based work in our *External Audit Plan 2017/18* and have updated this assessment during our interim visit. As a result of this we have identified the following significant VFM audit risks: — **Delivery of Budgets** — **Group Governance** See further details on page 24.
Exercising of audit powers	We have a duty to consider whether to issue a report in the public interest about something we believe the Authority should consider, or if the public should know about. We have not identified any matters that would require us to issue a public interest report. In addition, we have not had to exercise any other audit powers under the Local Audit & Accountability Act 2014.
Acknowledgements	We would like to take this opportunity to thank officers and Members for their continuing help.

Section one

Control Environment

Organisational and IT control environment

We have identified no significant issues with the Authority's organisational and IT control environment and consider that the overall arrangements that have been put in place are reasonable.

As part of our testing of IT Controls, we have made five recommendations, none of which are considered high priority.

Work completed

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would have implications for our audit. We obtain an understanding of the Authority's overall control environment and determine if appropriate controls have been implemented. We do not complete detailed testing of these controls.

The Authority relies on information technology ("IT") to support both financial reporting and internal control processes. In order to satisfy ourselves that we can rely on the use of IT, we test controls over access to systems and data, system changes, system development and computer operations. We have utilised our specialist IT team to undertake testing over the Authority's:

- general ledger system (Oracle);
- payroll system (Oracle); and
- revenues and benefits system (Northgate).

Key findings

We consider that your organisational and IT controls are effective overall, but noted five areas for further improvement:

- the IT Security Policy should be subject to annual review, but the policy had not been updated since 2015;
- 24 leavers with financial reporting responsibilities had not had their access revoked to Oracle Financials in a timely manner, some of whom had logged into Oracle after their HR leaving date. We tested these cases in further detail which did not highlight any significant issues;
- one leaver with parking permits responsibilities had not had their access to Northgate revoked in a timely manner;
- user access reviews for Northgate Revenues and Benefits are not carried out by the Authority; and
- the Authority operates a number of generic user access accounts within the general ledger system. We consider that the Authority should operate a proportionate form of monitoring / detective control over the use of these accounts as a way of improving control.

We have raised five recommendations for the Authority to mitigate the above issues which are set out within Appendix 1.

(continued overleaf)

Controls over key financial systems

Based on our testing the controls over the majority of the key financial systems are sound.

As part of our testing over journals we have a made a recommendation for the Authority to consider increasing the robustness of journal controls as part of the Fit For the Future project.

Work completed

We review the outcome of internal audit's work on the financial systems to influence our assessment of the overall control environment, which is a key factor when determining the external audit strategy.

Where we have determined that this is the most efficient audit approach to take, we evaluate the design and implementation of the control and then test selected controls that address key risks within these systems. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

Our assessment of a system will not always be in line with your internal auditors' opinion on that system. This is because we are solely interested in whether our audit risks are mitigated through effective controls, i.e. whether the system is likely to produce materially reliable figures for inclusion in the financial statements.

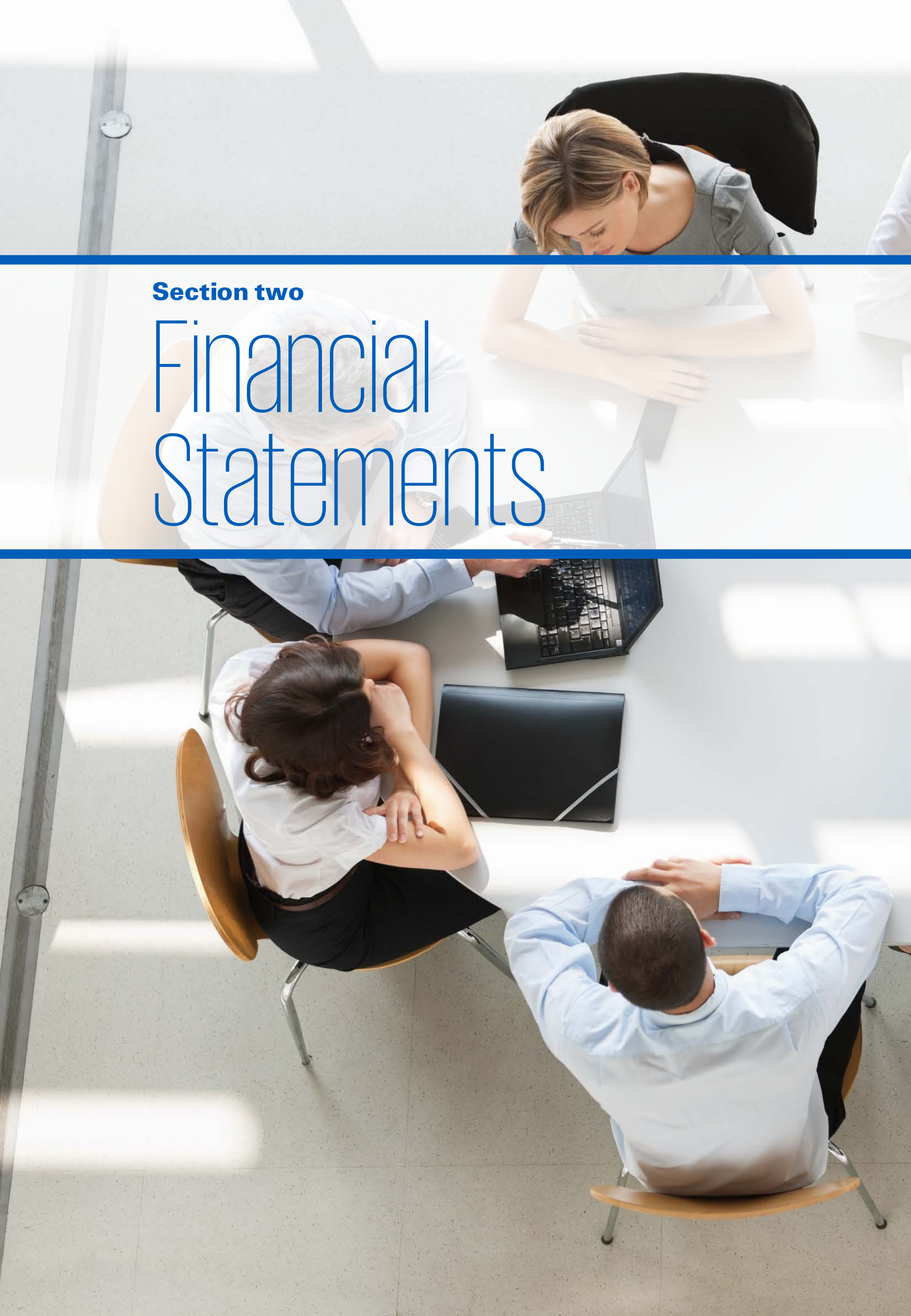
Key findings

Based on our work we have determined that the controls are sound over the financial systems that we regard to be key.

As part of our testing over journals we have a made a recommendation that the Authority considers increasing the robustness of journal controls as part of the Fit For the Future project. Specifically, at present there is no electronic segregation of duties where one individual posts a journal and a second individual authorises the journal. As part of the Fit For the Future project there is an opportunity to implement this control.

The Authority undertook a detailed reviewed and challenge of actuarial assumptions applied by the actuary in calculating the net pension liability, we noted that whilst we were informed this had been discussed and reviewed by senior finance staff, this review was not documented.

We have raised recommendations to reflect the above within Appendix 1.



Section two

Financial Statements

Accounts production and audit process

Audit standards (ISA 260) require us to communicate our views on 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. The efficient production of the financial statements and good-quality working papers are critical to meeting the tighter deadlines.

The Authority's overall process for the preparation of the financial statements is sound.

The Authority has implemented the majority of the recommendations in our *ISA 260 Report 2016/17*.

Accounts practices and production process

The Authority incorporated a number of measures into its closedown plan to further improve the project management of this complex process. This included essential and significant preparatory work in regards to ensuring the wider group was lined up to provide both draft and audited accounts to support the production of the Authority's Group accounts. The Authority recognised the additional pressures which the earlier closedown brought, and we engaged with officers in the period leading up to the year end in order to proactively address issues as they emerged.

We consider that the overall process for the preparation of your financial statements is sound. We also consider the Authority's accounting practices appropriate.

Going concern

The financial statements of the Authority have been prepared on a going concern basis. We confirm that we have identified no significant matters which would, in our view, affect the ability of the Authority to continue as a going concern.

We have provided further commentary on the Authority's arrangements in place to secure the effective delivery of budgets within our Value For Money conclusion on page 24.

Implementation of recommendations

We raised four recommendations in our ISA 260 Report 2016/17, none of which were high priority. The Authority has implemented the majority of the recommendations relating to the financial statements in line with the timescales of the action plan. There have however continued to be exceptions over the timely removal of leavers from the Northgate system, along with Northgate user access reviews, both of which are areas we highlighted for improvement in 2016/17. We have consequently raised new recommendations for 2017/18 which supersede the existing ones.

Completeness of draft accounts

We received a complete set of draft accounts on 31 May 2018, which is the new statutory deadline.

Quality of supporting working papers

We issued our Accounts Audit Protocol to Team Leader – Technical Accountant on 14 March 2018. This important document sets out our audit approach and timetable. It also summarises the working papers and other evidence we require the Authority to provide to support our audit work. This helps the Authority to provide audit evidence in line with our expectations. We followed this up with a meeting with management to discuss specific requirements of the document request list. This helped to ensure that working paper requirements are understood and aligned to our expectations. We are pleased to report that despite the shorter timescale officers again produced good quality working papers with clear management trails.

Accounts production and audit process (cont.)

Response to audit queries

We are pleased to report that our agreed turnaround time for dealing with audit queries was achieved by officers, including those who are not part of the Finance team. As a result of this, we expect to complete all of our audit work within the timescales expected.

Group audit

To gain assurance over the Authority's group accounts, we placed reliance on the work completed by component auditors on the financial statements of the Authority's subsidiaries:

— Robin Hood Energy Limited (turnover £70.4m)

— Nottingham City Transport Limited (turnover £53m)

— Nottingham City Homes Limited (turnover £63.5m)

— Blueprint Limited Partnership (turnover £6.1m)

— Bridge Estate (turnover £2.4m)

— Enviroenergy Limited (turnover £7.8m)

— Futures Advice, Skills and Employments Limited (turnover £18.2m)

— Nottingham Ice Centre Limited (turnover £15.6m)

— Nottingham Revenues and Benefits Limited (turnover £5.6m)

We are also pleased to report that there were no issues to note in relation to the consolidation process. The co-operation of officers, group entities and their respective auditors has enabled this and is a significant achievement by all concerned, especially given the unusually complex nature of this group structure.

As part of our audit of the group we have made the following observations:

— As per last year we considered RHE to be a significant component to our audit of the Group. We therefore wrote to RHE's auditors and at the time of writing this report we are reviewing their audit work

— The Authority converted a £7.5m loan to equity in year with Robin Hood Energy. The equity is held at cost as opposed to Fair Value on the Authority's balance sheet which is allowable as per the CIPFA Code. We are satisfied that there was no impairment required to the cost as held on the Authority's balance sheet.

— The Authority has a Service Level Agreement with Enviroenergy which is dated 1972. We consider that the Authority should revisit the SLA within or alongside the review of group governance. The Authority currently has £14.1m debtor with Enviroenergy, against this there is a bad debt provision of £5.5m. Enviroenergy has posted a £736k operating loss of 2017/18, however there has been no movement by the Authority in its review of the bad debt provision.

Capital Additions

Our testing over capital additions noted two areas where we have raised recommendations:

— the inclusion of additions relating to 2016/17. We undertook further work in regards to the capital cut-off for 2017/18, whilst our procedures provided us with assurance that capital additions are materially stated we did identify further errors; and

— for internally managed capital projects by Highways and Energy Infrastructure, the Authority applies a general 8% addition to any direct costs incurred for projects management costs, and a further 8% "surplus recovery fee". Whilst the amounts identified were not material, the Authority was unable to provide a robust assessment which set out how these amounts had been calculated and why it was appropriate to capitalise the "surplus recovery fee".

Specific audit areas

We anticipate issuing an unqualified audit opinion on the Authority's 2017-18 financial statements by 31 July 2018.

Auditing standards require us to consider two standard risks for all organisations. We consider these as a matter of course in our audit and will have set out the findings arising from our work in our ISA 260 Report below.

01

Management override of controls

Professional standards require us to communicate the fraud risk from management override of controls as significant because 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.

Our audit methodology incorporates the risk of management override as a default significant risk. 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.

02

Fraudulent revenue recognition

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 2017-18* 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.

Over the following pages we have set out our assessment of the specific significant risks and areas of audit focus we identified in relation to the audit of the Authority's financial statements.

Specific audit areas

Significant Audit Risks – Authority

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

Risk:

Valuation of Council Dwellings and Other Land and Buildings

Other land and buildings are generally required to be held at current value in existing use (EUV). As the majority of the Authority's buildings are specialised assets and there is not an active market for them, they are valued on the basis of the cost to replace them with an equivalent asset (Depreciated Replacement Cost or DRC).

There is significant judgement involved in determining the appropriate basis (EUV or DRC) for each asset according to the degree of specialisation, as well as over the assumptions made in arriving at the valuation of the asset. In particular the DRC basis of valuation requires an assumption as to whether the replacement asset would be built to the same specification.

The Authority has a rolling cycle of valuations, this therefore creates a risk that the carrying value of those assets not revalued in year differs materially from the year end fair value.

Council Dwelling valuations are based on Existing Use Value, discounted by a factor to reflect that the assets are used for Social Housing. The Social Housing adjustment factor is prescribed in DCLG guidance, but this guidance indicates that where a valuer has evidence that this factor is different in the Authority’s area they can use their more accurate local factor. There is a risk that the Authority's application of the valuer’s assumptions is not in line with the statutory requirements and that the valuation is not supported by detailed evidence indicating that the standard social housing factor is not appropriate to use.

For Other Land and Buildings Valuation is completed by an internal valuer and the for Council Dwellings by two external valuers (Freeman & Mitchell Limited and Herbert Button & Partners).

Our assessment and work undertaken:

We assessed the Authority’s valuation report for Council Dwellings, and for Other Land and Buildings and considered the revaluation basis used and its appropriateness. We engaged our property team experts to undertake an assessment of the revaluation;

We carried out an assessment of the expertise of the valuer instructed by the Authority to perform the revaluation exercises by ensuring that the valuer was appropriately qualified. We obtained the instructions provided to the valuer and assessed the independence and objectivity of the valuer and the terms under which they were engaged by management;

We considered the source of the information provided to, and used by, the valuer, and undertook testing to ensure both its completeness and accuracy, including the existence of assets and floor area measurements;

We confirmed the appropriateness of any amendments made by management to the information received from the valuer before being incorporated into the financial statements;

We considered management assessment of any need for an impairment across its asset base either due to loss of value or reduction in future benefits that would be achieved;

The Authority has significantly increased the amount of DRC properties revalued to mitigate the risk that properties not revalued are materially different to their fair value, as set out on page 17. At time of writing we are still completing our testing on PPE valuations, however at present we have not identified any issues which suggests valuations are not materially stated.

Specific audit areas (cont.)

Significant Audit Risks – Authority

Risk:

Pension Liabilities

The net pension liability represents a material element of the Authority's balance sheet. The Authority is an admitted body of the Nottinghamshire Pension Fund, which had its last triennial valuation completed as at 31 March 2016. This forms an integral basis of the valuation as at 31 March 2018.

The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Authority's overall valuation.

There are financial assumptions and demographic assumptions used in the calculation of the Authority's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should also reflect the profile of the Authority's employees, and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes.

There is a risk that the assumptions and methodology used in the valuation of the Authority's pension obligation are not reasonable. This could have a material impact on net pension liability accounted for in the financial statements.

Our assessment and work undertaken:

We critically assessed the competency, objectivity and independence of the Scheme's Actuary.

We reviewed the appropriateness of the key assumptions included within the valuation of the assets and the liabilities, with the use of a KPMG Actuary. Our Actuary also reviewed the methodology applied in the valuation by Scheme's Actuary.

We used the IAS 19 valuation provided by the Scheme Actuary for accounting purposes to ensure that this reconciled to the pension balances in the Authority's financial statements.

We liaised with the auditors of the Nottinghamshire Pension Fund (KPMG) in order to gain assurance that the controls in place at the Pension Fund were operating effectively. This included the process and controls in place to ensure data provided to the Actuary by the pension fund for the purposes of the IAS19 valuation was complete and accurate.

We agreed the estimated movement in the fair value of plan assets during the year included in the IAS 19 Actuarial Valuation as at 31 March 2018 for accounting purposes to the Authority's financial statements.

We found the resulting valuation of the Defined Benefit Pension Scheme Liability to be balanced, albeit this is subject to final confirmation from the pension fund auditor.

Specific audit areas (cont.)

Significant Audit Risks – Authority

Risk:

Faster Close

In prior years, the Authority has been required to prepare draft financial statements by 30 June and then final signed accounts by 30 September. For years ending on and after 31 March 2018 however, revised deadlines apply which require draft accounts by 31 May and final signed accounts by 31 July.

During 2016/17, the Authority started to prepare for these revised deadlines and advanced its own accounts production timetable so that draft accounts were ready by 12 June. Whilst this was an advancement on the timetable applied in preceding years, further work is still required in order to ensure that the statutory deadlines for 2017/18 are met.

In order to meet the revised deadlines, the Authority may need to make greater use of accounting estimates. In doing so, consideration will need to be given to ensuring that these estimates remain valid at the point of finalising the financial statements. In addition, there are a number of logistical challenges that will need to be managed. These include:

- Ensuring that any third parties involved in the production of the accounts (including valuers, actuaries, subsidiaries and subsidiary auditors are aware of the revised deadlines and have made arrangements to provide the output of their work in accordance with this;
- Revising the closedown and accounts production timetable in order to ensure that all working papers and other supporting documentation are available at the start of the audit process;
- Ensuring that the Audit Committee meeting schedules have been updated to permit signing in July; and
- Applying a shorter paper deadline to the July meeting of the Audit Committee meeting in order to accommodate the production of the final version of the accounts and our ISA 260 report.

In the event that the above areas are not effectively managed there is a significant risk that the audit will not be completed by the 31 July deadline.

There is also an increased likelihood that the Audit Certificate (which confirms that all audit work for the year has been completed) may be issued separately at a later date if work is still ongoing in relation to the Authority's Whole of Government Accounts (WGA) return. This is not a matter of concern and is not seen as a breach of deadlines.

Our assessment and work undertaken:

We liaised with officers in preparation for our audit in order to understand the steps that the Authority was taking in order to ensure it met the revised deadlines. We also advanced audit work into the interim visit in order to streamline the year end audit work.

We received draft financial statements on the statutory deadline of 31 May 2018. The quality of this draft was consistent with that of prior years despite the reduced timetable. We expect to complete the WGA return in time to give the certificate alongside the opinion.

Specific audit areas (cont.)

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.

Issue:

Group Accounts including Robin Hood Energy Limited

The Authority has a relatively complex Group structure and will therefore need to ensure its Group Accounts are complete and intra group transactions correctly identified and removed.

As we noted in our prior year ISA260 report, one of the Authority's subsidiaries, Robin Hood Energy Ltd (RHE), has seen significant increases in turnover and outturn position since 2015/16, this included posting a £7.5 million operating loss in 2016/17, although we note that this is expected to be improved in 2017/18. As per last year we have made RHE a significant component for our audit.

Our assessment and work undertaken:

We reviewed the consolidation procedures in place at the Authority, and the Authority's assessment of all entities over which the Authority has control or significant influence and the Authority's subsequent consideration whether or not to consolidate each entity within the Group Accounts.

We discussed the process to identify and eliminate intra-group transactions.

We agreed the final accounts consolidation back to audited financial statements for each subsidiary, joint venture and Trust fund consolidated within the Group Accounts.

We liaised formally with RHE's auditor's to enable us to make use of the outcome of their audit (including their opinion) for our audit opinion on the Authority's Group Accounts, this included a review of RHE's auditor file. We also note that RHE's financial performance improved to being in surplus for 2017/18.

We did not identify any significant issues as a result of the work undertaken.

We have considered wider group governance arrangements as part of our Value For Money work on page 26, where we have raised a recommendation.

Issue:

Implications of Tramlink's auditors' comments regarding going concern

Tramlink Nottingham Ltd is one of the Authority's key external partners. The company is a PFI concession who built the tram lines for NET Phase 2, and now operates and maintains all tram lines in Nottingham.

In their 2016/17 financial statements, Tramlink's auditors' issued an Emphasis of Matter paragraph within their opinion in regards to going concern and financial uncertainties linked to breaching bank covenant ratios.

Our assessment and work undertaken:

We discussed with the Authority the latest position in regards to Tramlink Nottingham Ltd and any implications for the Authority's financial statements. Our discussions did not highlight any significant issues at the present time in terms of our responsibilities. Officers also explained how they monitor Tramlink.

As part of the partnership with Tramlink Nottingham Ltd, the Authority has in place two key arrangements to help protect its interests, these being:

— Funders Direct Agreement; and

— Concession Agreement.

Specific audit areas (cont.)

Other areas of audit focus (cont.)

Issue: **Broadmarsh Development**

The Authority has begun work on its Broadmarsh redevelopment with the demolition of the Broadmarsh car park. The Authority is due to submit plans to Executive Board for approval in regards to the next phase of the project in developing a new car park and shopping centre.

The work to date will have an impact upon the financial statements, through disposing of the existing car park, and capitalising costs incurred up to 31 March 2018.

Our assessment and work undertaken:

We considered the accounting treatment of the Broadmarsh development as at 31 March 2018, specifically limited to the accounting treatment of the demolition of the car park and capitalisation of costs incurred to date. We did not identify any significant issues as part of the work undertaken in regards to the accounts treatment of costs incurred in 2017/18.

We had planned to discuss with officers the financial plans of the project including proposed financing and financial plan, however the redevelopment is yet to be approved by the Authority's Executive Board and therefore outside the scope of our audit for 2017/18.

Issue: **Proposed changes to Minimum Revenue Provisions**

The Authority has informed us that they are considering making changes to the way it calculates its Minimum Revenue Provision (MRP) which has the potential to have a significant financial impact.

Our assessment and work undertaken:

We reviewed the proposed changes to the MRP policy.

We considered how the Authority communicated to its Members the financial impact of the changes, including in the medium and long term.

The Authority has made changes to its MRP Policy prior to 1 April 2018. The changes impact on the supported borrowing elements of the MRP charge. As part of our review of the revised methodology we did not identify any issues which would lead us to challenge the revision. Whilst the changes result in a c.£4m reduction in MRP charges over the next seven years, it subsequently increases the charge from 2024/25 by c. £655k. We are satisfied that this has been communicated clearly to the Authority's members.

Specific audit areas (cont.)

Other areas of audit focus (cont.)

Issue:	**Commercial Property Investment** In 2016/17 the Authority invested £87.5 million in commercial properties. The Authority set out within its 2017/18 budget a planned £41.85m of further investment property acquisitions for 2017/18, and it is anticipated that valuation of the Authority's investment property portfolio will exceed £200m by the year-end. The Authority will need to ensure that all commercial property investments are valued at fair value at 31 March 2018, that there are arrangements in place to ensure associated borrowing is sustainable, and that arrangements are in place to cope with events such as impairment of the assets.
Our assessment and work undertaken:	We reviewed the valuation of commercial property investments, including new additions in year. We considered the arrangements to assess the sustainability of borrowings both individually and as a whole to the Authority's investment property portfolio, and the financial robustness of the Authority if the assets decrease in value. The Authority has invested £94.9m into investment properties throughout 2017/18. The majority of these are outside of the Nottingham area and are held to help generate additional revenue for the Authority to support the revenue budget. We sample tested investment property additions to ensure that the transaction was completed in year and that the purchase price was accurately reflected within the financial statements. Investment properties purchased in year have not been subsequently revalued which we considered a reasonable approach. We met with the Head of Portfolio Investment and Development to understand in further detail the due diligence undertaken ahead of each purchase and did not identify any significant issues. We are aware that the Authority's Audit Committee has received a presentation on approach to commercial property investments during the year. We also note that the Authority's internal auditors reviewed the governance arrangements underpinning commercial property investments, and made a number of recommendations were made and accepted by management to help strengthen current arrangements. Given the growth of the Authority's investment property portfolio it is vital that the Authority has in place a Capital Investment Strategy as soon as possible, and that this is appropriately approved and monitored against. We have raised a recommendation to reflect this.

Judgements

We have considered the level of prudence within key judgements in your 2017-18 financial statements and accounting estimates. We have set out our view below across the following range of judgements.

Level of prudence

0	1	2	3	4	5	6
Audit Difference	Cautious		Balanced		Optimistic	**Audit Difference**
	Acceptable Range					

Subjective area	2017-18	2016-17	Commentary
Provisions	4	4	The Authority's provision balance has reduced by £5.02m from the prior year (CY £34.67m, PY £39.68m). The Authority's provision balance reduced by £2.99m in 2016/17. We therefore consider that the Authority is heading towards the more optimistic end of the prudence scale. Our review of provisions has focussed on the Authority's three main provisions. 1. The provision linked to compulsory purchases associated with the NET2 Tram Scheme (CY £14.06m PY £16.1m). The provision represents outstanding compulsory purchases where the final purchase price is yet to be agreed, the balance has reduced by £2.04m in year as a number of acquisition prices have been agreed. 2. Since 2013/14 the Authority has been responsible for a proportion of successful rateable value appeals. To calculate the provision, the Authority utilises an external expert, Analyse Local. The provision is based on the latest list of outstanding business rate appeals provided by the Valuation Office Agency. This has resulted in a decrease in the provision of £2.54m. £2.9m of the provision relates to 2017 Valuations. Currently there is no available appeals information from the Valuation Office Agency relating to the 2017 Valuation following the introduction of a new appeals process. We agree that it is prudent to set aside this estimated amount as it is reasonable to assume that there will be successful appeals emerging from the new process. However, in our view, the most appropriate way to do this would be to create a reserve rather than a provision (which requires there to be an obligating event under IAS 37). Officers have set out to us why they are content that they have met the requirements of IAS 37, and have confirmed that they will continue to review their approach to setting aside resources for potential 2017 appeals as updates are received from the Valuation Office. 3. Injury Damage and Compensation Claims provision has increased in year from £11.95m to £13.05m (increase of £1.1m). This represents the increases in claims against the Authority.

Judgements

Subjective area	2017-18	2016-17	Commentary
Property Plant & Equipment: Council Dwellings	3	3	As at the 31 March 2018 the Authority's housing stock consists of 25,808 properties. The Authority continues its use of the beacon methodology in line with the DCLG's *Stock Valuation for Resource Accounting* published in November 2016. The year-end valuation for 2017/18 is £921.2m, an increase of £85.2m from the prior year balance (£835.9m), of which £74.3m is a result of upwards revaluations. Of the revaluation gain, £51.2m impacts on the Authority's Comprehensive Income and Expenditure Statement (CIES), and subsequently has been separated out as an exceptional item on the face of the CIES. The Authority has utilised two external valuation experts to provide valuation estimates on a desktop basis. We have reviewed the instructions provided and deem that the valuation exercise is in line with the instructions. The valuation is based on 193 property beacons. We noted that resulting increases across the beacons ranges between -6% - +25%. We utilised a KPMG valuation specialist to review the valuation utilising available market data. The desktop valuation is not underpinned purely by regional indices but also utilises other comparable market data such as house price sales in similar regions to each property beacon. Our review of the valuation is being finalised however at present we have not identified any issues and we consider it balanced.
Property Plant & Equipment: Other Land and Buildings	3	3	The Authority's Other Land and Buildings balance as at 31 March 2018 is £897.1m, an increase of £102.8m from the prior year balance of £794.3m. This increase has been primarily driven by revaluation gains. The Authority has significantly increased the number of valuations undertaken in year to reduce the risk that as part of its cyclical revaluation programme, assets not revalued in year have a material difference between their carrying value and fair value. £725.5m of Other Land and Buildings have been revalued in year, of this £674m utilising a Depreciated Replacement Cost methodology to represent the specialised nature of the Authority's assets where there is often no market, and £51m utilising Existing Use Value. We utilised a KPMG valuation specialist to review a sample of valuations to review the reasonableness of underpinning assumptions which is currently being finalised but at time of writing has not highlighted any issues. We therefore consider the valuation to be balanced.

Judgements (cont.)

Subjective area	2017-18	2016-17	Commentary
Valuation of Local Government Pension Scheme (LGPS) pension assets and liabilities	3	3	The Authority's total net pension liability is £820.2m (PY £860.8m), underpinned by two defined benefit pension schemes, the LGPS and Teachers' Pension Scheme. Given the significance of the LGPS we focus our audit work on this element of the pension element. At the 31 March 2018, LGPS pension liabilities for the Authority totalled £1,860m (PY £1,884m), and the fair value of pension assets totalled £1,077m (PY £1,063m), resulting in a net LGPS pension liability of £782.4m (PY £820.5m). The Authority continues to use Barnett Waddingham to provide actuarial valuations in relation to the assets and liabilities recognised as a result of participation in the Local Government Pension Scheme. Due to the overall value of the pension assets and liabilities, small movements in the assumptions can have a significant impact on the overall valuation. The actual assumptions adopted by the actuary fell within our expected ranges as set our below:

Assumption	Actuary Value	KPMG Range	Assessment
Discount rate	2.55%	2.51%	3
Pension increase rate	2.3%	2.15%	2
Salary Growth	CPI plus 1.5%	CPI plus 0 – 2%	3
Life expectancy Males currently aged 45 / 65 Females currently aged 45 / 65	 24.8 / 22.6 27.9 / 25.6	 23.5 / 22.1 25.4 / 23.9	3

We found assumptions to be within our acceptable range. There has been an actuarial gain on the financial assumptions of around £71.8m, largely due to a fall in the assumptions for pension and salary increases, offset to an extent by a fall in the discount rate assumption.

Proposed opinion and audit differences

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's 2017-18 financial statements following approval of the Statement of Accounts by the Audit Committee on 23 July 2018.

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 4) for this year's audit was set at £10.5 million for the Authority (and £11m for the Group). Audit differences below £525k are not considered significant.

We did not identify any material misstatements. We identified one non-material adjustment. There are no unadjusted audit differences. 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 2017-18 ('the Code'). We understand that the Authority will be addressing these where significant.

The Authority has significantly increased the number of revaluations undertaken in year in regards to Other Land and Buildings in order to strengthen the robustness of valuations. At time of preparing the draft statements there were a relatively small number of revaluations which were still to be finalised (officers had explained to us in advance that this would be the case). During the first week of the audit the Authority finalised the revaluations and these have been audited and reflected in the post-audit statement of accounts, details of which are provided separately to the Audit Committee by officers.

Annual Governance Statement

We have reviewed the Authority's 2017-18 Annual Governance Statement and confirmed that:

— It is not misleading and is consistent with other information we are aware of from our audit of the financial statements.

Narrative Report

We have reviewed the Authority's 2017-18 Narrative Report and have confirmed that it is consistent with the financial statements and our understanding of the Authority. We provided feedback on the Narrative Report, for which the Authority reflected all comments within the final version.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's 2017/18 financial statements, with the exception of a breach that we regard as having a minor impact.

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 for the year ending 31 March 2018, 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, with the exception of a breach that we regard as having a minor impact. We have provided a detailed explanation of the breach in a separate letter to the Committee, and summarised it within our declaration in Appendix 7 in accordance with ISA 260. We have also requested that the Committee confirms that it concurs with our assessment of the breach on our independence.

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 Responsible Finance Officer 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 judgement, 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 or our previous reports relating to the audit of the Authority's 2017-18 financial statements.

Section three

Value for Money Arrangements

Specific value for money risk areas

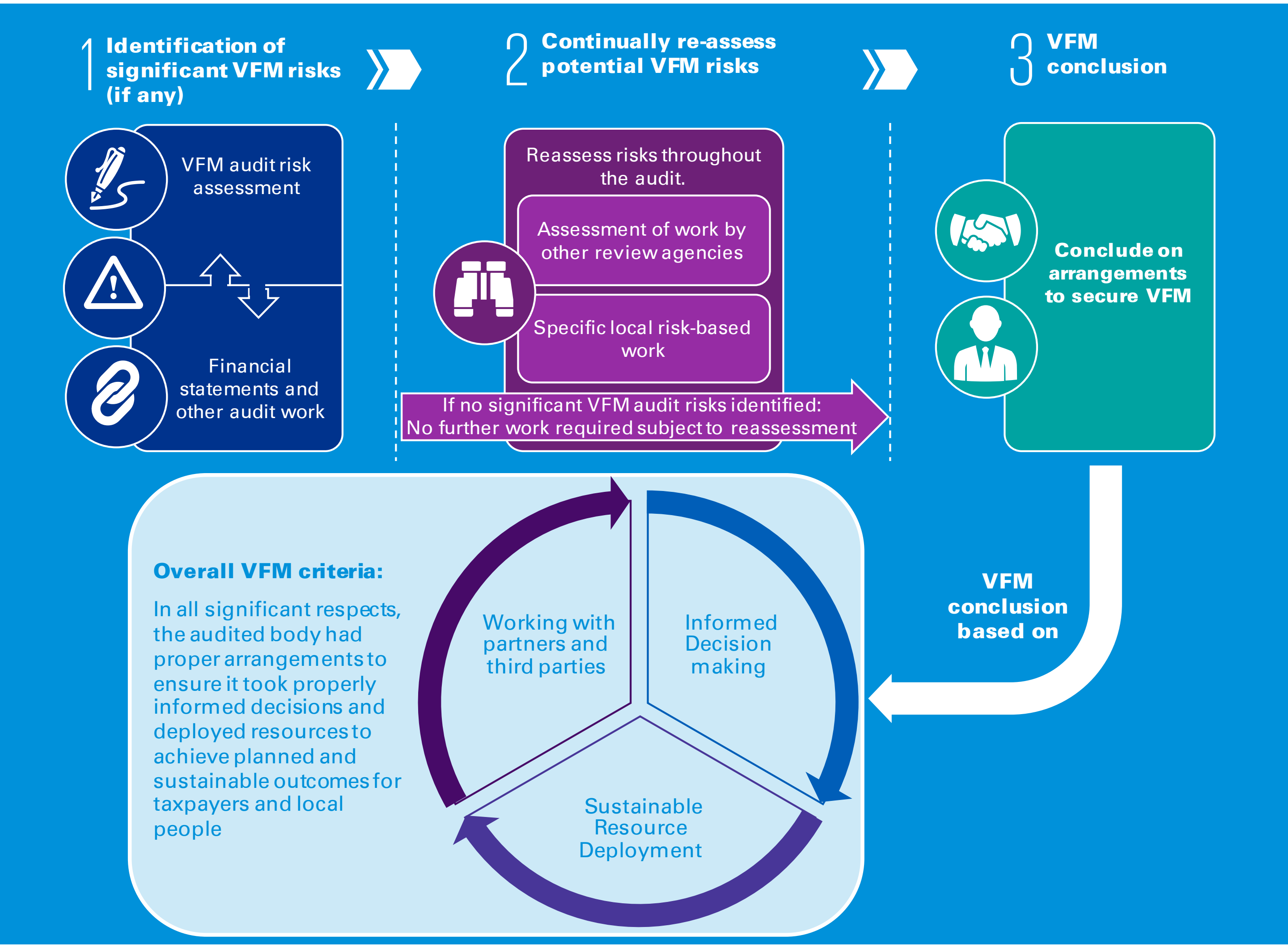
Our 2017-18 VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We have concluded that the Authority has made proper arrangements to ensure it took properly-informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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.'

We follow a risk based approach to target audit effort on the areas of greatest audit risk.



Specific value for money risk areas (cont.)

The table below summarises our assessment of the individual VFM risks identified against the three sub-criteria. This directly feeds into the overall VFM criteria and our value for money opinion.

Applicability of VFM area of focus to VFM sub-criteria

VFM area of focus	Informed decision making	Sustainable resource deployment	Working with partner and third parties
Delivery of budgets	✓	✓	✓
Group governance arrangements	✓	✓	✓

In consideration of the above, we have concluded that in 2017-18, the Authority has made proper arrangements to ensure it took properly-informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Further details on the work done and our assessment are provided on the following pages.

Specific value for money risk areas (cont.)

As communicated to you in our *External Audit Plan 2017-18,* and as updated throughout the audit, we have identified two risks requiring specific audit attention and procedures to address the likelihood that proper arrangements are not in place to deliver value for money.

In all cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

We have provided below a summary of the risk areas identified, our work undertaken and the conclusions reached.

Risk:

Delivery of budgets

The Authority's 2017/18 net revenue budget of £238.54m was approved by full Council in March 2017. The forecast at Quarter 2, stated that the Authority will deliver an overspend which has been forecasted at: £2.65m (Best case), £2.70m (Medium Case) or £6.55m (Worst Case).

Proposed savings for 2017/18 have been planned at £24.45m from savings on both portfolios and health integration as per the 2017/18 budget. Further savings of £25.86m and £29.14m for 2018/19 and 2019/20 respectively will be required principally to address future reductions to local authority funding alongside service cost and demand pressures as set out within the Medium Term Financial Plan, notably within Adult Social Care. As a result, the need for savings along with income generation from commercial activity will continue to have a significant impact on the Authority's financial resilience, as it strives to put in place a sustainable budget

In addition, the Authority's overall level of borrowing as at 31 March 2017 was £796.26m. As reported to Audit Committee in January 2018 via the Treasury Management Half Yearly Update, external borrowing is expected to increase by £255m in 2017/18 based on the revised capital program and forecast cashflow requirements.

Therefore we consider this to be a significant risk.

Our assessment and work undertaken:

As part of our additional risk based work we have undertaken the following procedures over this significant risk:

- reviewed the Authority's Medium Term Financial Plan, and consider the proposed actions to mitigate factors such as funding reductions, salary and general inflation, demand pressures, restructuring costs and sensitivity analysis given the degree of variability in the above factors;
- reviewed the reported actual delivery of the Authority's savings programme compared to planned savings;
- reviewed the arrangements in place to ensure that overall borrowing levels are sustainable;
- reviewed the budget and savings plan for 2018/19, including any contingencies.

As part of our work in regards to the delivery of the Authority's budget we have made the following observations and assessments.

For the second consecutive year the Authority's year-end position is an overspend. For 2017/18 this equates to a adverse variance of £4.22m against budget. The adverse variance is indicative of the overarching financial pressures the Authority is under, as seen across the sector, including the continued demand for social care services. One of the contributing factors to the year-end position was the inclusion of £10.1m expected

Specific value for money risk areas (cont.)

Significant VFM Risks

Our assessment and work undertaken:

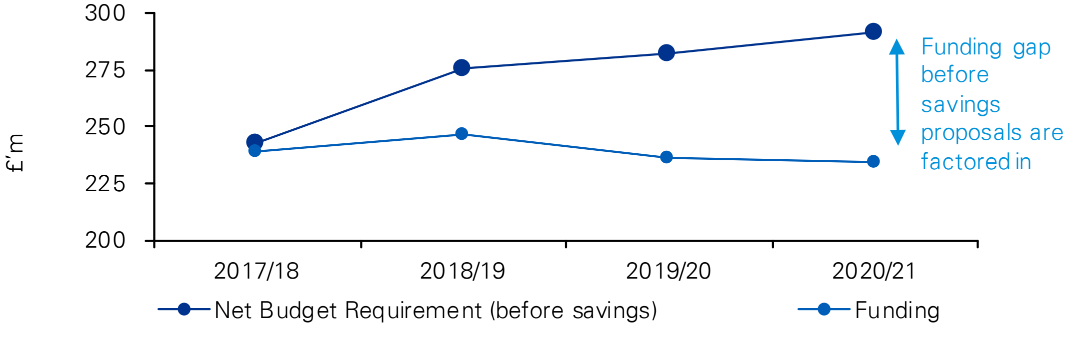
Delivery of Budgets (cont.)

benefit from the Sustainability and Transformation Partnership which did not materialise. The Authority has been transparent however in its reporting of this, and sought to rectify it as reported in its Quarter 1 position to both Executive Board and Council. This has meant the Authority has resorted to a number of non-recurrent measures to reduce the budget deficit, along with a net transfer from reserves of £2.9m. This use of non-recurrent measures inherently compound the challenges in delivering a balanced budget in 2018/19.

As a result of the overspend in year, the Authority's General Fund (GF) balance has reduced from £8.46m to £5.47m, and is close to the Authority's minimum GF level of 2% of the budget requirement. The Authority has committed to working to replenish this, thus ensuring sufficient contingencies exist for any future unexpected events which could have a detrimental impact on the revenue budget.

The Authority has reported total savings from 2010/11 to 2017/18 of £232.7m. As financial pressures continue into the 2018/19's budget, the Authority has worked hard to develop £23.08m of portfolio savings, £5.3m of targeted savings aimed at discretionary intervention services, and a further £1m from a partnership funding review. Total proposals for 2018/19 are a challenging £29.38m. The proposals have allowed the Authority however to set a net budget position of £246.36m, funded by retained business rates, and revenue support grant (£131m), council tax (£110m) and collection funds £4.9m). Whilst the Authority is working hard to deliver its revenue budget the Corporate Leadership Team (CLT) will need to monitor the on-going financial results closely through the year and take decisive action to address emerging cost pressures, with a focus on ensuring measures are recurrent.

The Medium Term Financial Plan details the increasingly difficult financial challenges faced each year, resulting in the need for ever rising savings which have yet to be identified. The budget gap by 2020/21 is estimated to be £57.78m. It is important that the Authority commits to delivering a sustainable budget, which will require strong leadership.



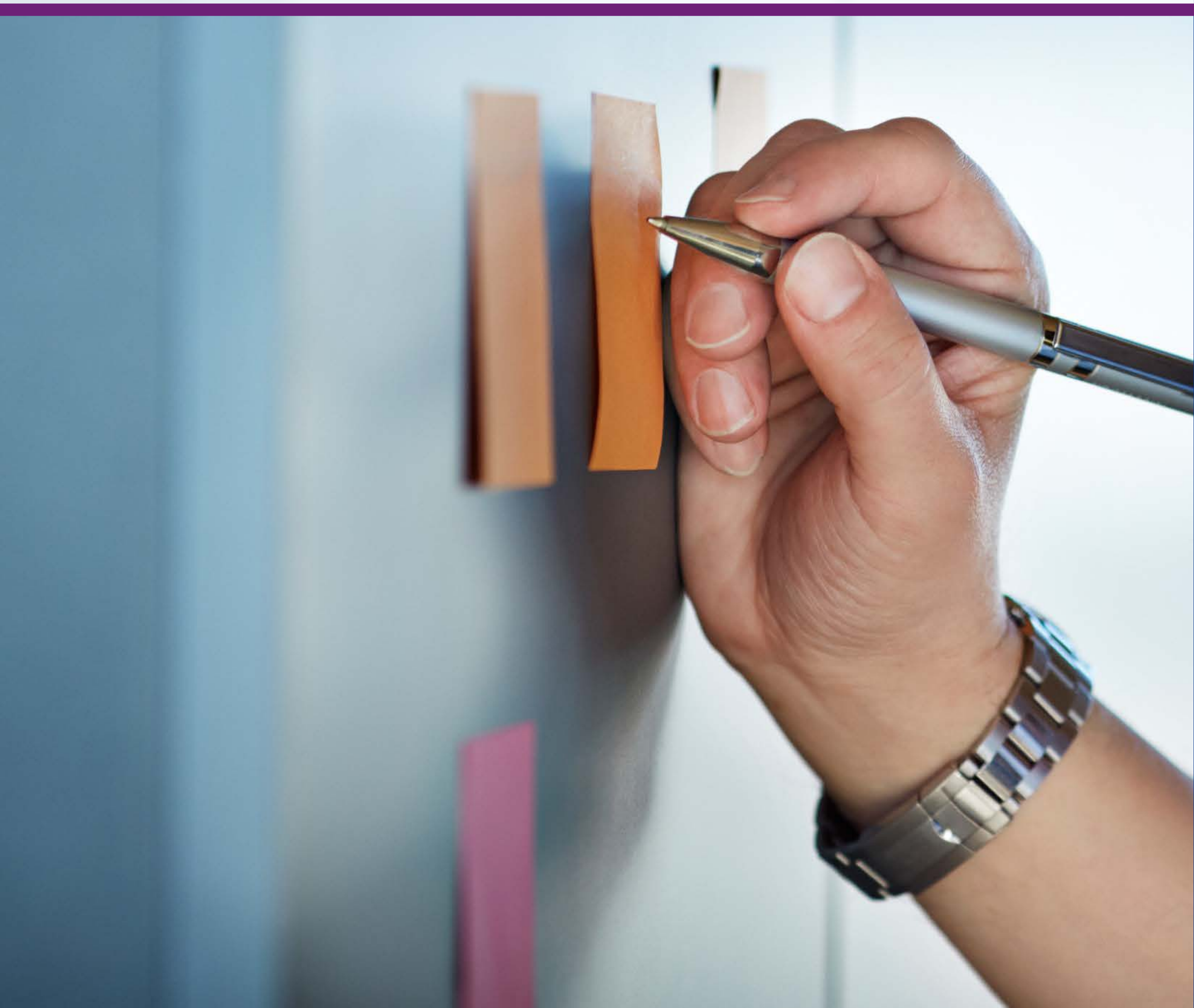
Whilst not specifically part of the Authority's revenue budget, we did also observe the increasing level of the Authority's external borrowing. This is likely to significantly increase further to support a potentially sizeable capital programme. At present the Authority does not have in place an up-to-date capital strategy, and it is vital given the size of the capital programme that this is developed and factors in the borrowing and potential exposure and adverse impact external conditions could have on the Authority's financial position given the level of external debt. We have raised a recommendation to acknowledge this.

Specific value for money risk areas (cont.)

Significant VFM Risks

Risk:	**Group Governance Arrangements** The Authority has a relatively complex group structure. In 2016/17 the Authority consolidated within its group accounts, six subsidiaries, two joint ventures and one trust fund. Of these, most notably was the expansion of the Robin Hood Energy (RHE), which we classified as a significant component. For 2017/18, further growth of RHE is forecast, and we have therefore continued to classify RHE as a significant component. The Authority has recognised that as its group structure evolves, then so must the overarching governance arrangements in place at the Authority to monitor and ensure that appropriate accountability of the respective subsidiaries and joint ventures are in place. At time of our planning the Authority was in the process of commencing a key review of the Authority's group governance arrangements. In addition to this for years ending on and after 31 March 2018 revised deadlines apply which require draft accounts by 31 May and final signed accounts by 31 July. In order to meet the revised deadlines, there are a number of logistical challenges that will need to be managed, one of which is ensuring that any third parties (subsidiaries and subsidiary auditors) involved in the production of the accounts are aware of the revised deadlines and have made arrangements to provide the output of their work in accordance with the closedown and accounts production timetable.
Our assessment and work undertaken:	As part of our work we have: — reviewed the current governance arrangements in place surrounding the current group structure: — sought to consider the findings from the Authority's own internal review of group governance arrangements, however at time of writing this is yet to be finalised. We referred to this review in our prior year ISA260 report, where the terms of reference for the internal review were presented to Audit Committee in September 2017. The Authority has been progressing its overarching group governance processes to ensure that these are fit for purpose given the continued growth of the group. We note that whilst progress has been made, officers and members are taking care to design a framework that meets their requirements. It is important that developing and implementing the revised structure is completed by the target date of September 2018. We have raised a recommendation to reflect this. In terms of the financial statements, the Authority's Finance team have worked very effectively with the subsidiaries to ensure that they were able to meet the Authority's own deadlines for producing Group financial statements, and for the end of July deadline.

Appendices



Appendix 1:

Key issues and recommendations

Our audit work on the Authority's 2017-18 financial statements has identified a number of issues, none of which are consider high priority. We have listed these issues in this appendix together with our recommendations which we have agreed with Management. We have also included Management's responses to these recommendations.

The Authority should closely monitor progress in addressing the risks, including the implementation of our recommendations.

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

Priority Rating for Recommendations

1	**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. Recommendations Raised: -	2	**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. Recommendations Raised: 8	3	**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. Recommendations Raised: 5

No.	Risk	Issue & Recommendation	Management Response
1	2	**Sustainable Financial Budget** The Authority has highlighted a number of risks regarding its ability to deliver a self-sufficient and sustainable financial budget in the medium term. Many of these risks are not specific to the Authority but to the sector as a whole, underpinned by reduced central funding and increasing demand for social care services. The Authority's outturn for 2017/18 and 2016/17 has been an overspend against budget. For 2017/18 the Authority has relied on a number on non-recurrent measures to help reduce the in year-overspend. Despite setting a balanced budget for 2018/19, it is likely that there will be emerging financial pressures that will require co-ordinated action by CLT. ***Recommendation*** CLT needs to monitor the financial position within 2018/19 and work together to deliver solutions to any issues that arise. Wherever non-recurrent measures are used to address recurrent issues there should be a clear plan as to the proposed solution for the future.	[Details of management response.] ***Responsible Officer*** [Name] – [Role] ***Implementation Deadline*** [Date]

Appendix 1:

Key issues and recommendations

No.	Risk	Issue & Recommendation	Management Response
2	2	**Group Governance Arrangements** The Authority has been progressing its overarching group governance processes to ensure that these are fit for purpose given the continued growth of the group. We consider that whilst progress has been made, it is important that the new framework meets the September 2018 implementation target date. ***Recommendation*** The Authority should ensure that the new group governance framework is in place by September 2018.	[Details of management response.] ***Responsible Officer*** [Name] – [Role] ***Implementation Deadline*** [Date]
3	2	**Capital Investment Strategy** Given the significant growth of the Authority's investment property portfolio it is vital that the Authority has in place a Capital Investment Strategy, we understand that this is something that the Authority has commenced developing given the confirmed level of planned capital and investment expenditure. ***Recommendation*** The Authority should develop and appropriately approve a capital investment strategy document as soon as possible, given the growth of its investment property portfolio and associated borrowing costs.	[Details of management response.] ***Responsible Officer*** [Name] – [Role] ***Implementation Deadline*** [Date]
4	2	**Journals Authorisation** Historically, journals posted by the Authority do not require authorisation. From a control environment point of view ideally there should be a robust segregation of duties where journals are posted by one individual, and then separately authorised electronically within the general ledger system. We understand that the new general ledger system has this functionality, and therefore we strongly recommend that the approvals functionality is considered as part of the implementation of the new system. There is a risk that without robust journal controls, inappropriate or inaccurate journals could be posted to the general ledger system. ***Recommendation*** The Authority should investigate and seriously consider the implementation of electronic journal authorisation within the new general ledger system.	[Details of management response.] ***Responsible Officer*** [Name] – [Role] ***Implementation Deadline*** [Date]

Appendix 1:

Key issues and recommendations

No.	Risk	Issue & Recommendation	Management Response
5	2	**Capital Cut-Off** Our testing over capital additions noted the inclusion of additions relating to 2016/17. We undertook further work in regards to the capital cut-off for 2017/18, whilst our procedures provided us with assurance that capital additions are materially stated we did identify further errors. We consider that this is an area the Authority revisits for future years to ensure the process to identify and account for capital accruals is robust. The errors identified related to schemes delivered internally. ***Recommendation*** The Authority should review its process for capturing and accounting for capital accruals, to ensure costs are capitalised in the correct period, notably in regards to internally delivered schemes.	[Details of management response.] ***Responsible Officer*** [Name] – [Role] ***Implementation Deadline*** [Date]
6	2	**Capitalising project management costs and surplus recovery fees** Our testing of capital additions identified that for internally managed capital projects by Highways and Energy Infrastructure, the Authority applies a general 8% addition to any direct costs incurred for project management costs, and a further 8% "surplus recovery fee". Whilst the amounts identified were not material, the Authority was unable to provide a robust assessment which set out how the 8% assumptions applied had been generated. We consider that project management costs should be applied at staff level as opposed to general percentage. ***Recommendation*** The Authority should: — review how it calculates its capitalised project management costs, notably the 8% add-on cost; and — review the basis of the "surplus recovery fee" capitalised cost for internally managed capital projects and why it is appropriate to capitalise this cost.	[Details of management response.] ***Responsible Officer*** [Name] – [Role] ***Implementation Deadline*** [Date]

Appendix 1:

Key issues and recommendations

No.	Risk	Issue & Recommendation	Management Response
7	3	**Documenting senior review and approval of actuarial assumptions** The Authority undertook a detailed review and challenge of actuarial assumptions applied by the Actuary in calculating the net pension liability, we noted that whilst we were informed this had been discussed and reviewed by senior finance staff, this review was not documented. There is a risk that should the actuarial assumptions ever be retrospectively challenged over their appropriateness, there is no audit trail to reflect appropriate timely scrutiny and review. ***Recommendation*** Actuarial assumptions should be reviewed and signed off by Senior Management at the Authority before the production of draft accounts.	[Details of management response.] ***Responsible Officer*** [Name] – [Role] ***Implementation Deadline*** [Date]
8	2	**Enviroenergy** As part of our testing we noted two key areas related to Enviroenergy: 1. The Authority currently has £14.1m debtor with Enviroenergy, against this there is a bad debt provision of £5.5m within the Authority's accounts. Enviroenergy has posted a £736k operating loss for 2017/18, however there has been no movement in the bad debt provision from the prior year. 2. The Authority has incurred capital additions c.£3m in maintaining the infrastructure utilised by Enviroenergy. Borrowing costs to fund the capital spend are past onto Enviroenergy as part of the existing SLA. We noted however that the SLA between the Authority and Enviroenergy is dated 1972. It is important that the financial positon of Enviroenergy is monitored and the Authority's exposure on its long term debtor reflected within its statements. There is a risk that without regular review the service level agreement between the Authority and Enviroenergy will not reflect current operations. ***Recommendation*** The Authority should review and confirm that the service level agreement it has with Enviroenergy, dated 1972 is still fit for purpose. The Bad debt provision against Enviroenergy's debtor should be reviewed for 31 March 2019.	[Details of management response.] ***Responsible Officer*** [Name] – [Role] ***Implementation Deadline*** [Date]

Appendix 1:

Key issues and recommendations

No.	Risk	Issue & Recommendation	Management Response
9	3	**IT Security Policy** The Authority's IT Security Policy should be subject to annual review, but the policy has not been updated since 2015. There is a risk that the policy is out of date, notable against the backdrop of General Data Protection Regulations which impact from 25 May 2018. ***Recommendation*** IT Security Policy should be reviewed annually as determined by the Authority.	[Details of management response.] ***Responsible Officer*** [Name] – [Role] ***Implementation Deadline*** [Date]
10	2	**Northgate Leavers** Our testing identified one leaver with parking permits responsibilities had not had their access revoked to Northgate in a timely manner. We were able to mitigate the risk through further testing however leavers should be removed from systems in a timely fashion. ***Recommendation*** The Authority should ensure that leavers are removed immediately from the Northgate system.	[Details of management response.] ***Responsible Officer*** [Name] – [Role] ***Implementation Deadline*** [Date]
11	3	**Northgate User Access** User access reviews for Northgate Revenues and Benefits are not carried out by the Authority. We identified one leaver with parking permits responsibilities who had not had their access revoked to Northgate in a timely manner. ***Recommendation*** Annual user access reviews should take place on the Northgate system.	[Details of management response.] ***Responsible Officer*** [Name] – [Role] ***Implementation Deadline*** [Date]
12	3	**Oracle Leavers** 24 leavers with financial reporting responsibilities had not had their access revoked to Oracle Financials in a timely manner, some of which had logged into Oracle after their HR leaving date. We were able to mitigate the risk through further testing . ***Recommendation*** Oracle leavers should be removed from system immediately.	[Details of management response.] ***Responsible Officer*** [Name] – [Role] ***Implementation Deadline*** [Date]

Key issues and recommendations

No.	Risk	Issue & Recommendation	Management Response
13	3	**Oracle Generic Accounts** The Authority operates Generic User Accounts, which we do not consider unreasonable, however we do consider that the Authority should operate a monitoring / detective control over the use of these accounts as a way of improving control. This should be realistic as usage of these accounts should be in exceptional circumstances only. ***Recommendation*** The Authority should introduce a monitoring control over the use of Generic User Accounts within the general ledger.	[Details of management response.] ***Responsible Officer*** [Name] – [Role] ***Implementation Deadline*** [Date]

Appendix 2:

Follow-up of prior year recommendations

The Authority has not implemented all of the recommendations raised through our previous audit work.

We re-iterate the importance of the outstanding recommendations and recommend that these are implemented as a matter of priority.

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2016/17* and re-iterates any recommendations still outstanding.

Number of recommendations that were	
Included in our ISA 260 Report 2016/17	4
Implemented in year or superseded	2
Supersceded	2

No.	Risk	Issue & Recommendation	Status as at 23 July 2018
1	2	**Northgate Leavers** We performed a comparison against leavers from the Authority and users with Access to the Northgate system. We identified 11 users who had left the Authority but continued to still be set-up with access on the Northgate system. There were in place mitigations, and all leavers had their Windows Network access removed. If a user does not access the system for 35 days then their account is automatically locked. The leavers had access to Northgate as their manager has not informed IT, and Northgate is yet to fully integrate with the HR leavers process. ***Recommendation*** The Authority should ensure all leavers with access to Northgate are removed immediately. The Northgate system should be integrated into the HR leaver process and manager reminded to notify IT that Northgate access needs to be revoked on leaving the Authority.	**Superseded by recommendation 10** Whilst improvements have been made in year our testing identified one leaver with parking permits responsibilities had not had their access revoked to Northgate in a timely manner.

Appendix 2:

Follow-up of prior year recommendations

No.	Risk	Issue & Recommendation	Status as at 23 July 2018
2	3	**General Ledger Batch Controls** East Midland Shared Service (EMSS) operate a control whereby if a general ledger batch job fails, it is added to an error log, given a unique ID and tracked as the EMSS team resolve and find a solution. As part of our audit of General IT Controls, we noted that whilst batch job fails were being resolved, they had not been logged for the second half of the year (from September 2016.) ***Recommendation*** The Authority should continue to log all general ledger batch control fails in the error log.	**Implemented** No issues identified by KPMG follow-up. The IT team will only track failed requests if they have been submitted by the System Administrator (username SYSADMIN). Any failures are investigated on a daily basis. All other requests are monitored by the individual requestor.
3	3	**Processing of new joiners on payroll** As part of this process there is a check performed by payroll to ensure that the information entered by HR into the payroll system is accurate. As part of our audit testing we noted that for one individual, there was no evidence that this check had been performed. Through discussion it has been confirmed that the process varies slightly dependent upon the individual within the payroll team who is setting up the new joiner or making the amendment. The checks are always performed by payroll, however some individuals do not print off the E-form, add ticks to evidence the check and sign it to show that the check has been complete. Therefore there is no evidence that these checks have taken place. ***Recommendation*** The Authority should ensure consistency in regards to processing of new joiners and that controls support the accuracy of data input into the payroll system.	**Implemented** No issues identified by KPMG testing in 2017/18.

Appendix 2:

Follow-up of prior year recommendations

No.	Risk	Issue & Recommendation	Status as at 23 July 2018
4	3	**Northgate Access Reviews** Annual reviews of user access on the Northgate system do not take place, we were informed that it is picked up typically when there is a major system upgrade, approximately every five years. Best practice states that when individual staff change positions or leave, their manager should inform IT of the change of role so that access rights can be changed to match those of a "profiler" (i.e. somebody who already has the access they now need). There should be annual reviews of what access groups need to be able to do. ***Recommendation*** The Authority should continue to log all general ledger batch control fails in the error log.	**Superseded by recommendation 11.** User access reviews for Northgate Revenues and Benefits are still not carried out by the Authority. We identified one leaver with parking permits responsibilities who had not had their access revoked to Northgate in a timely manner. We were able to mitigate the risk

Audit differences

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.

A number of minor amendments focused on presentational improvements have also been made to the 2017-18 draft financial statements. The Finance team is committed to continuous improvement in the quality of the financial statements submitted for audit in future years.

Adjusted audit differences – Authority

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 2018. It is our understanding that these will be adjusted.

Table 1: Adjusted audit differences – Authority (£'000)

No.	Income and expenditure statement	Income and expenditure statement	Basis of audit difference
1	Dr Interest and similar charges and income £2.52m	Cr Other Finance and Investment £2.52m	Classification Error
	Dr £2.52m	**Cr £2.52**	**Total impact of adjustments 0**

Unadjusted audit differences

There are no unadjusted audit differences.

Materiality and reporting of audit differences

The assessment of what is material is a matter of professional judgement and includes consideration of three aspects: materiality by value, nature and context.

Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.

Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.

Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We used the same planning materiality reported in our *External Audit Plan 2017-18*, presented to you in June 2018.

Materiality for the Authority's accounts was set at £10.5 million (£11 million for the Group) which equates to around 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 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, an individual difference is considered to be clearly trivial if it is less than £0.525 million for the Authority (£0.550 million for the Group).

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 5:

Required communications with the Audit Committee

We have provided below at-a-glance summary of the information we are required to report to you in writing by International Accounting Standards.

Required Communication	Commentary
Our draft management representation letter	We have not requested any specific representations in addition to those areas normally covered by our standard representation letter for the year ended 31 March 2018.
Adjusted audit differences	We have identified one adjusted differences as a result of our audit of the Authority's financial statements.
Unadjusted audit differences	We have identified no unadjusted differences as a result of our audit of the Authority's financial statements
Related parties	There were no significant matters that arose during the audit in connection with the entity's related parties.
Other matters warranting attention by the Audit Committee	There were no matters to report arising from the audit that, in our professional judgement, are significant to the oversight of the financial reporting process.
Control deficiencies	We have set out our assessment of the Authority's internal control environment, including confirmation that there were no significant deficiencies identified, in Section one of this report.
Actual or suspected fraud, noncompliance with laws or regulations or illegal acts	We identified no actual or suspected fraud involving the Authority's Member or officers with significant roles in internal control, or where the fraud resulted in a material misstatement in the financial statements.
Significant difficulties	No significant difficulties were encountered during the audit.
Modifications to auditor's report	There are no modifications to our audit report (subject to completion of WGA by the time of giving the opinion)
Disagreements with management or scope limitations	The engagement team had no disagreements with management and no scope limitations were imposed by management during the audit.
Other information	No material inconsistencies were identified related to other information in the Narrative Report or Annual Governance Statement. These reports were found to be fair, balanced and comprehensive, and compliant with applicable requirements.
Our declaration of independence and any breaches of independence	The engagement team have complied with relevant ethical requirements regarding independence, with the exception of a single breach of FRC Ethical Standards. See Appendix 7 for further details.
Accounting practices	Over the course of our audit, we have evaluated the appropriateness of the Authority's accounting policies, accounting estimates and financial statement disclosures. In general, we believe these are appropriate. We have set out our view of the assumptions used in valuing pension assets and liabilities at page 18.

KPMG

Document Classification: KPMG Confidential

Appendix 5:

Required communications with the Audit Committee (cont.)

Required Communication	Commentary
Key audit partner	We identified the key audit partner at page 24 in our *External Audit Plan 2017-18* presented to you in June 2018.
Significant matters discussed or subject to correspondence with management	There were no significant matters arising from the audit which were discussed, or subject to correspondence, with management.
Independence of external experts engaged by KPMG and non-KPMG auditors	We have not engaged external experts for the performance of any aspects of our audit.
Communications with Audit Committee and management	We have described the nature, frequency and extent of communication with the Audit Committee and management at page 22 in our *External Audit Plan 2017-18* presented to you in June 2018.
Scope and timing of the audit	We have described the scope and timing of the audit at page 22 in our *External Audit Plan 2017-18* presented to you in June 2018.
Audit methodology	There are no substantial variations in our approach from the previous year's audit.
Valuation methods	On pages 16-18, we report the valuation methods applied to the items in the financial statements and the impact of any changes.
Going concern assessment	There are no significant matters affecting the entity's ability to continue as a going concern. The CIPFA Code of Practice states that all local authority financial statements shall be prepared on a going concern basis.
Requested explanations and documents	No matters to report. All requested explanations and documents were provided by management.
Materiality	Quantitative materiality applied to the audit of the financial statements as a whole and materiality for balances/disclosures affected by qualitative factors is set out at page 12 in our *External Audit Plan 2017-18* presented to you in June 2018. See also Appendix 4 of this report.
Non-compliance with laws and regulation or articles of association	No actual or suspected non-compliance with laws and regulation or articles of association were identified during the audit
Non-KPMG component auditors	We described the work of non-KPMG component auditors at page 8.
Management's approach to consolidation	We report on management's approach to consolidation on page 41. It is consistent with the requirements of the Code. The consolidated financial statements include all material subsidiaries.

Appendix 6:

Consolidation of IFRS Group Financial Statements

We explain the scope of consolidation and the exclusion criteria applied by Nottingham City Council to the non-consolidated entities and our views on whether they comply with the financial reporting framework.

In accordance with the financial reporting framework, which is IFRS 10, the scope of the consolidated financial statements includes Nottingham City Council and all subsidiaries except those that may or are required to be excluded under IFRS 10.

The criteria for exclusion are in accordance with the financial reporting framework.

Identification of subsidiaries:	Applied [Y/N]	Not Applicable
– entities controlled by the company whereby the company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.	Y	
– **Permitted exclusion:**		
– immaterial subsidiaries	Y	
Required exclusions:		
– post-employment benefit plan in the scope of IAS 19		Y
– where Nottingham City Council is an investment entity, all subsidiaries other than those that are not itself an investment entity and whose main purpose and activities are providing services that relate to the Nottingham City Council's investment activities.		Y

Declaration of independence

ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF NOTTINGHAM CITY COUNCIL

Professional ethical standards require us to provide to you at the conclusion of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed.

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code of Audit Practice, the provisions of Public Sector Audit Appointments Limited's ('PSAA's') Terms of Appointment relating to independence, the requirements of the FRC Ethical Standard and the requirements of Auditor Guidance Note 1 - General Guidance Supporting Local Audit (AGN01) issued by the National Audit Office ('NAO') on behalf of the Comptroller and Auditor General.

This Statement is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

— General procedures to safeguard independence and objectivity;

— Breaches of applicable ethical standards;

— Independence and objectivity considerations relating to the provision of non-audit services; and

— Independence and objectivity considerations relating to other matters.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP partners, Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. As a result we have underlying safeguards in place to maintain independence through:

— Instilling professional values

— Communications

— Internal accountability

— Risk management

— Independent reviews.

The conclusion of the audit engagement leader as to our compliance with the FRC Ethical Standard in relation to this audit engagement and that the safeguards we have applied are appropriate and adequate is subject to review by an engagement quality control reviewer, who is a Partner not otherwise involved in your affairs.

We are satisfied that our general procedures support our independence and objectivity except for those detailed below where additional safeguards are in place.

Independence and objectivity considerations related to breaches of the FRC Ethical Standard

During the year there has been one breach of certain aspects of applicable independence regulations, as reported to you in a separate paper on 20 July 2018. That breach related to providing pensions advisory advice to Nottingham City Transport, which was finalised in August 2017. The work was provided prior to our awareness that the Authority was classified a public interest entity as a result of £617k of listed debt. The service provided however was not permissible to be provided to a public interest entity under FRC Ethical

Declaration of independence (cont.)

Independence and objectivity considerations related to breaches of the FRC Ethical Standard (cont.)

standards. We have concluded the breach did not impact on our independence and objectivity as auditors of the Authority 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 Authority'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 Authority's results, KPMG are not the auditors of this Company or the Fund, therefore safeguarding any possible self-review threat. No members of the Authority's audit team were involved in the work for the Company .
3. Finally, we note that this is our last year as auditors of the Authority 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.

Independence and objectivity considerations relating to the provision of non-audit services

Summary of fees

We have considered the fees charged by us to the Authority and its controlled entities for professional services provided by us during the reporting period. We have detailed the fees charged by us to the Authority and its controlled entities for significant professional services provided by us during the reporting period in Appendix 8, as well as the amounts of any future services which have been contracted or where a written proposal has been submitted. Total fees charged by us for the period ended 31 March 2018 can be analysed as follows:

	2017-18 (£)	2016-17 (£)
Audit of the Authority	172,118	178,727
Total audit services*	**172,118**	**178,727**
Non-audit services	19,475	0
Audit related assurance services	10,500	13,200
Total Non Audit Services	**29,975**	**13,200**
Mandatory assurance services (Housing Benefits certification)	18,458	10,965**
Total Mandatory Assurance Services	**18,458**	**10,965**

*We have carried out additional work in a number of areas referred to in this report (eg PIE, group) and will discuss additional fee with the S151 officer. Any agreed fee will also be subject to PSAA agreement.

**2016/17 Housing Benefits work subject to fee variation yet to be agreed and confirmed with PSAA

We are required by AGN 01 to limit the proportion of fees charged for non-audit services (excluding mandatory assurance services) to 70% of the total fee for all audit work carried out in respect of the Authority under the Code of Audit Practice for the year. The ratio of non-audit fees to audit fees for the year was 17% . We do not consider that the total of non-audit fees creates a self-interest threat since the absolute level of fees is not significant to our firm as a whole.

Facts and matters related to the provision of non-audit services and the safeguards put in place that bear upon our independence and objectivity, are set out in the table on the following page.

We have agreed with the PSAA that our £31,000 fee for strategic advisory services work for Midlands Engine, procured on its behalf by the Authority, does not count towards the fee threshold as it is not for the

Declaration of independence (cont.)

Independence and objectivity considerations relating to the provision of non-audit services (cont.)

Authority. For clarity, your audit team is not involved in the Midlands Engine work. We are carrying out further work for the Midlands Engine in 2018/19 procured on its behalf by the Authority, and PSAA has again agreed that it is not relevant in terms of the thresholds as it is again not for the Authority.

Appropriate approvals have been obtained from PSAA for all non-audit services above the relevant thresholds provided by us during the reporting period.

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the Audit Committee.

Analysis of Non-audit services for the year ended 31 March 2018

Description of scope of services	Principal threats to independence and Safeguards applied	Basis of fee	Value of services delivered in the year ended 31 March 2018 £	Value of services committed but not yet delivered £
Allowable non-audit services				
Pensions Advisory Services for Nottingham City Transport	Self-interest: These engagement is entirely separate from the audit through a separate contract. In addition, the audit fee scale rates were set independently to KPMG by the PSAA. Therefore, the proposed engagement will have no perceived or actual impact on the audit team and the audit team resources that will be deployed to perform a robust and thorough audit. Self review: The nature of this other 'assurance' work has no impact on the 2017/18 audit as it relates to 2016/17 financial year. Therefore, it does not impact on our opinion and we do not consider it to be a threat to our role as external auditors. We do not audit the Nottingham City Transport (NCT) in regards to our pensions work. Management threat: This work involved the certification of these returns only –all decisions were made by the Authority. In regards to the pensions work, we are not the auditors for NCT. Familiarity: This threat is limited given the scale, nature and timing of the work. Advocacy: We will not act as advocates for the Authority in any aspect of this work. We have drawn on our experience in such roles to certify the returns but the scope of this work falls well short of any advocacy role. Intimidation: Not applicable.	Fixed daily rate	19,475	0

Note – an element of this work was subsequently deemed to be not compatible with PIE status, leading to the breach declaration within this section.

Declaration of independence (cont.)

Analysis of Non-audit services for the year ended 31 March 2018 (cont.)

Description of scope of services	Principal threats to independence and Safeguards applied	Basis of fee	Value of services delivered in the year ended 31 March 2018 £	Value of services committed but not yet delivered £
Audit-related assurance services				
Grant Certification – Teachers Pensions Return		Fixed Fee	2,500	0
Grant Certification – Pooling of Housing Capital Receipts Return	The nature of these audit-related services is to provide independent assurance on each of these returns. As such we do not consider them to create any independence threats.	Fixed Fee	4,000	0
SFA Sub-contracting Controls Assurance		Fixed Fee	4,000	0
Mandatory assurance services				
Grant Certification – Housing Benefit Subsidy Return	The nature of this mandatory assurance service is to provide independent assurance on each of the returns. As such we do not consider it to create any independence threats.	Fixed Fee	10,965	18,458

Confirmation of audit independence

We confirm that as of the date of this report, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the Audit Committee of the Authority and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

KPMG LLP

KPMG LLP

Appendix 8:

Audit fees

As communicated to you in our *External Audit Plan 2017-18*, our scale fee for the audit is £172,118 plus VAT (£172,118 in 2016/17), which is consistent with the prior year.

However, we propose an additional fee due to reclassification of the Authority to an EU PIE and other issues set out in this report. We will discuss and agree any additional fee with the S151 officer. This will be subject to PSAA's final determination.

Our work on the certification of the 2016/17 Authority's Housing Benefit Subsidy return is not yet complete. The planned scale fee for this is £10,965 plus VAT. Planned fees for other grants and claims which do not fall under the PSAA arrangements amount to £10,500 plus VAT (£13,200 in 2016/17), see further details below.

Component of the audit	2017-18 Planned Fee £	2016-17 Actual Fee £
Accounts opinion and value for money work		
PSAA Scale fee Nottingham City Council	172,118	172,118
Additional fee	tbc*	6,609
Total audit services	**172,118**	**178,727**
Mandatory assurance services		
Housing Benefits Certification	18,458	10,965*
Total mandatory assurance services	**18,458**	**10,965**
Audit-related assurance services		
Teachers' Pension Return	2,500	2,500
Pooling of Housing Capital Receipts	4,000	4,000
Local Transport Grant	0	3,000
SFA Subcontracting Controls	4,000	3,000
Total audit-related assurance services	**10,500**	**12,500**
Total non-audit services	**19,475**	**0**
Total fees for the Authority	**220,551**	**202,192**

All fees quoted are exclusive of VAT.

The key contacts in relation to our audit are:

Tony Crawley
Director

T: +44 (0) 796 6184819
E: tony.crawley@kpmg.co.uk

Tom Tandy
Manager

T: +44 (0) 776 888 8287
E: thomas.tandy@kpmg.co.uk

Arvinder Khela
Assistant Manager

T: +44 (0) 121 609 5880
E: arvinder.khela@kpmg.co.uk

kpmg.com/uk