External Audit ISA260 Report 2017/18

Nottinghamshire County Council and Nottinghamshire Pension Fund

July 2018

Summary for Governance and Ethics Committee

This document summarises the key findings in relation to our 2017-18 external audit at Nottinghamshire County Council ('the Authority') and Nottinghamshire Pension Fund.

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

Organisational and IT control environment	Considerable improvements have been made to the IT control environment of the Authority's SAP system following our recommendations raised in 2016-17; however we have made additional recommendations that are designed to further enhance it.
Accounts production	We received a complete set of draft accounts on 30 May 2018, which is before this year's statutory deadline of 31 May 2018. The Authority continues to have a strong financial reporting process as illustrated by finalising of the accounts in a shorter timescale.
Controls over key financial systems	We have tested controls as part of our focus on significant audit risks and other parts of your key financial systems on which we rely as part of our audit. Based on the work performed, we are satisfied that the controls are performing effectively. We are able to place reliance on the Authority's control framework.
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 reporting to you in our *External Audit Plan 2017/18*) we identified the following significant risks (excluding those mandated by International Standards on Auditing – see **Page 10 and onwards**): — **Valuation of PPE** – The Authority operates a cyclical revaluation approach, the Code requires that all land and buildings be held at fair value. We considered the way in which the Authority ensures that assets not subject to in-year revaluation are not materially misstated. We also reviewed the instructions and source of the information provided to, and used by, the valuer to inform the Authority's valuation; — **Pensions Liabilities** – The valuation of the Authority's pension liability, as calculated by the Actuary, is dependent upon both the accuracy and completeness of the data provided and the assumptions adopted. We reviewed the processes in place to ensure accuracy of data provided to the Actuary and considered the assumptions used in determining the valuation. We have not identified any material audit adjustments. We have raised three recommendations which can be found in **Appendix 1**. Subject to clearance of our final queries and final (including Director) review we are moving into the completion stage of the audit. We will not be able to issue our certificate alongside the opinion and VFM conclusion due to the outstanding objection to the 2015/16 statement of accounts and the Whole of Government Accounts work being outstanding.

Summary for Governance and Ethics Committee (cont.)

Pension Fund financial statements	**Subject to all outstanding queries being resolved to our satisfaction we anticipate issuing an unqualified audit opinion in relation to the Pension Fund's financial statements by 31 July 2018.** Based upon our initial assessment of risks to the Pension Fund financial statements (as reporting to you in our *External Audit Plan 2017/18* and updated during our interim visit) we have identified the following significant risks (excluding those mandated by International Standards on Auditing – see **Page 12**): — **Valuation of hard to price investments** – The Pension Fund invests in a range of assets and funds, some of which are inherently harder to value due to there being no publicly available quoted prices. We have verified a sample of investments to third party information and confirmations.
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 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 therefore anticipate issuing an 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 audit. As a result of this we have identified the following significant VFM audit risk. — **Medium Term Financial Planning** – The Authority continues to face similar financial pressures and uncertainties to those experienced by others in the local government sector. For 2017/18, the Authority has a balanced budget, but the updated Medium Term Financial Strategy (MTFS) 2018/19 to 2021/22 identifies a gap of £54.7m between 2018/19 and 2021/22 as a result of increasing cost pressures and reductions in grant funding. We have reviewed the arrangements the Authority has in place to ensure financial resilience. See further details on **Page 23**.
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 relation to our 2017/18 audit. 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 continued 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.

Despite this, we have noted areas for further improvement, specifically in relation to segregation of duties for IT administrators.

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 are in place. 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 tested controls over access to systems and data, system changes, system development and computer operations.

Key findings

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

— Issue 1: An assessment of privileged user access rights also identified a number of potential segregation of duties conflicts that reduced the effectiveness of established change management processes; these were notified to the Authority; and

— Issues 2 & 3: Opportunities to further improve controls around access revocation and passwords.

As a result we have made recommendations - see **Appendix 1**.

Aspect of controls	Assessment
IT controls:	
Access to systems and data	3
System changes and maintenance	2
Development of new systems and applications	3
Computer operations and end-user computing	3

Key

1	Significant gaps in the control environment.
2	Deficiencies in respect of individual controls
3	Generally sound control environment.

Controls over key financial systems

From the testing undertaken, the controls over all of the key financial systems within our scope are sound.

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.

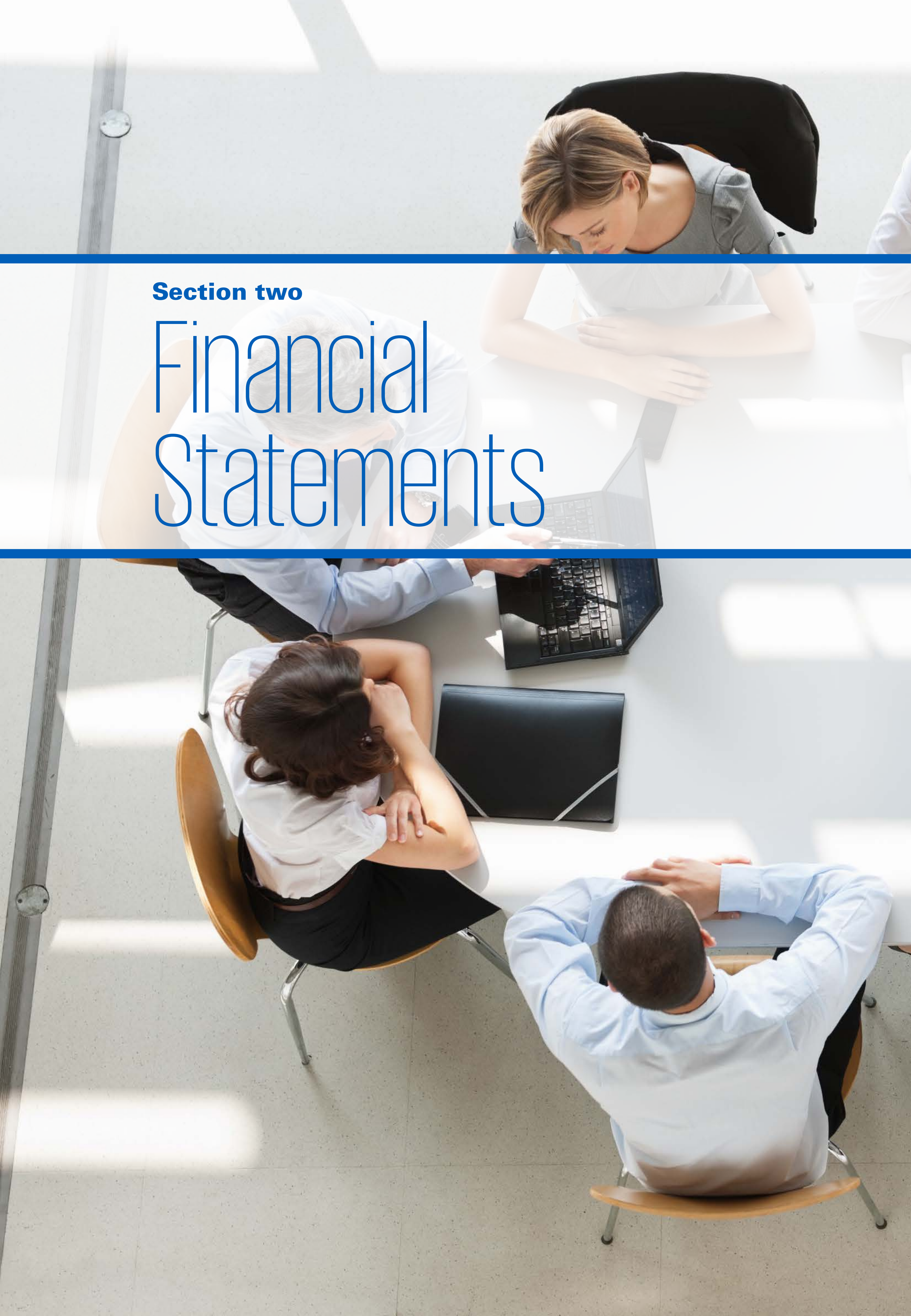
Our assessment of a system will not always be in line with your internal auditors' opinion on that system. This is because we are solely interested in whether our audit risks are mitigated through effective controls, i.e. whether the system is likely to produce materially reliable figures for inclusion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

Key findings

We have tested controls as part of our focus on significant audit risks and other parts of your key financial systems on which we rely as part of our audit. Based on the work undertaken, we have determined that the controls over the key financial systems within our scope are sound.

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 good.

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

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. Specifically, the Authority recognised the additional pressures which the earlier closedown brought and completed a 'dry run' in 2016/17. We also engaged with officers in the period leading up to the year end in order to proactively address issues as they emerge.

We consider that the overall process for the preparation of your financial statements is good. Our audit timetable was moved forward to accommodate the faster close, the Authority produced working papers and a first draft of the accounts on 30 May 2018 within the statutory deadline of 31 May 2018.

Going concern

The financial statements of both the Authority and the Pension Fund 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 or Pension Fund to continue as a going concern.

Further commentary on the Authority's arrangements in place to secure the financial resilience is included at **Page 23**.

Implementation of recommendations

We raised one recommendation in our ISA 260 Report 2016/17. The Authority has implemented the recommendation relating to the IT control environment in line with the timescales of the action plan. Further details are included in **Appendix 2**.

Completeness of draft accounts

We received a complete set of draft accounts on 30 May 2018, which is in advance of the statutory deadline.

Quality of supporting working papers

We issued our Accounts Audit Protocol to the finance team in February 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 and the Pension Fund to provide audit evidence in line with our expectations.

Accounts production and audit process (cont.)

We worked with management to ensure that working paper requirements are understood and aligned to our expectations. We are pleased to report that this has resulted in good quality working papers with clear audit trails.

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, all of our audit work was completed within the timescales expected. This achievement puts the Authority in a good position to take on the 2017/18 earlier closedown with no significant concerns.

Pension Fund audit

The audit of the Fund was completed alongside the main audit. There are no specific matters to bring to your attention relating to this.

Specific audit areas

We anticipate issuing an unqualified audit opinion on the Authority's 2017-18 financial statements and those of the Pension Fund 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 and those of the Pension Fund.

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 PPE** The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Authority has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle. As a result of this, however, individual assets may not be revalued for four years. This creates a risk that the carrying value of those assets not revalued in year differs materially from the year end fair value.
Our assessment and work undertaken:	We reviewed the approach that the Authority adopted to assess the risk that assets not subject to valuation were materially misstated and considered the robustness of that approach. In relation to those assets which have been revalued during the year we reviewed the accounting entries made to record the results of the revaluation in order to ensure that they were appropriate. We also assessed the valuer’s qualifications, objectivity and independence to carry out such valuations and reviewed the methodology used (including testing the underlying data and assumptions). As a result of this work we determined that the valuation is appropriately stated.

Specific audit areas (cont.)

Significant Audit Risks – Authority (cont.)

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 to net pension liability accounted for in the financial statements.
Our assessment and work undertaken:	As part of our work we reviewed the controls that the Authority has in place over the information sent to the Scheme Actuary, including the Authority's process and controls with respect to the assumptions used in the valuation. We also evaluated the competency, objectivity and independence of Barnett Waddingham. We reviewed the appropriateness of the key assumptions included within the valuation and, compared them to expected ranges which involved a KPMG Actuary to provide a specialist assessment of those assumptions. We also reviewed the methodology applied in the valuation by Barnett Waddingham. In addition, we reviewed the overall Actuarial valuation and considered the disclosure implications in the financial statements. In order to determine whether the net pension liability has been appropriately accounted for we also considered the valuation of pension assets. As part of our audit of the Pension Fund we gained assurance over the overall value of fund assets. We then reviewed the methodology of how these assets are allocated across participating bodies. Work on pension fund is on-going due to clarifications sought from the actuary. We have set out our view of the assumptions used in valuing pension assets and liabilities at **page 15**.

Other areas of audit focus

Other areas of audit focus – 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. 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 and subsidiaries) 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 Governance and Ethics Committee meeting schedule has been updated to permit signing in July; and - Applying a shorter paper deadline to the July meeting of the Governance and Ethics 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 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 return and the Pension Fund Annual Report. This is however 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 in advance of the statutory deadline of 31 May 2018. The quality of this draft was consistent with that of prior years, with only minor presentational adjustments were identified.

Specific audit areas (cont.)

Significant Audit Risks – Pension Fund

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

Risk:	**Valuation of hard to price investments** The Pension Fund invests in a wide range of assets and investment funds, some of which are inherently harder to value or do not have publicly available quoted prices, requiring professional judgement or assumptions to be made at year end. The pricing of complex investment assets may also be susceptible to pricing variances given the number of assumptions underlying the valuation. In the prior year financial statements, £660 million out of a total of £4,932 million of investments, or 13%, were in this harder to price category. For year ended 31 March 2018, £793 million out of a total of £5,172 million of investments, or 15%, were in this harder to price category.
Our assessment and work undertaken:	As part of our audit of the Pension Fund, we independently verified a selection of investment asset prices to third party information and obtained independent confirmation on asset existence. We also tested the extent to which the Pension Fund had challenged the valuations reported by investment managers for harder to price investments and obtained independent assessment of the figures. As a result of this work we determined that investment assets had been appropriately 'tiered' into the fair value hierarchy levels. We also determined that management had challenged the valuations reported by investment managers, especially when valuations had been 'rolled-forward' on a cash flow basis.

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 (excluding Business Rates)	3	3	The Authority provisions (excluding Business Rates) have decreased by £1.3million since last year, primarily due to a reduction in the insurance provision. We consider these Provisions to be balanced.
Business Rates provision	3	3	Since 2013/14 the Authority has been responsible for a proportion of successful rateable value appeals. The NNDR business rates appeals provisions have decreased slightly during the year to £2 million (2016/17: £2.9 million). We consider this provision to be balanced
Property Plant & Equipment: Assets	3	3	The Authority carries out a rolling valuation programme that ensures that all Property, Plant and Equipment required to be re-measured are revalued every 5 years. All valuations have been carried out by a specialist team internally. Due to significant increase in build costs the Authority have revalued all of its depreciated replacement cost (DRC) property assets to ensure they reflect the correct valuation as at 31 March 2018. We consider this to be a prudent approach.

Judgements (cont.)

Subjective area	Commentary
Valuation of pension assets and liabilities	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. For example, a 0.1% change in the discount rate would change the net liability by £50.219 million. The below table compares Authority's and KPMG's assumptions using the range on the previous page. The overall set of assumptions proposed by the Authority are within our acceptable range and are considered to be balanced relative to KPMG's central rates for a typical UK scheme with a duration of 19 years.

Assumption	Authority	KPMG	Assessment (See previous page for range definitions)	Commentary
Discount rate	2.55%	2.51%	3	The proposed assumption is considered to be balanced and within our normally acceptable range.
Pension Increase Rate	2.30%	2.15%	1	The proposed assumption is considered to be cautious but within our normally acceptable range.
Salary increases	CPI plus 1.5%	CPI plus 0% to 2.0%	3	We would typically expect salary increases to fall in the range of CPI plus 0% to 2%. Salary increase assumptions have been derived consistently with the approach taken at the most recent LGPS valuation. We would consider this approach to be reasonable.
Life expectancy at retirement 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	1	The life expectancies assumptions are consistent with those used in the most recent LGPS valuation and can be considered acceptable.

Proposed opinion and audit differences (cont.)

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.

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 Governance and Ethics Committee on 25 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 3**) for this year's audit was set at £18.6 million. Audit differences below £0.93 million are not considered significant.

We did not identify any material misstatements. In addition, we identified a small number of presentational adjustments required to ensure that the accounts are compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2017-18 ('the Code'). We understand that the Authority will be addressing these where significant.

Pension Fund financial statements

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Pension Fund's 2017-18 financial statements following approval of the Statement of Accounts by the Governance and Ethics Committee on 25 July 2018.

Pension Fund audit

Our audit of the Fund also did not identify any material misstatements.

For the audit of the Fund we used a higher materiality level of £50 million. Audit differences below £2.5 million are not considered significant.

We identified a small number of presentational adjustments required to ensure that the accounts are compliant with the Code. We understand that the Fund will be addressing these where significant.

Annual report

The statutory deadline for publishing the annual report is 1 December 2018. The Pension Fund Annual Report is currently due to be approved by the Pension Fund AGM on 4 October 2018. We will need to complete additional work in respect of subsequent events to cover the period between signing our opinions on the Statement of Accounts and the Pension Fund Annual Report.

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.

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 Nottinghamshire County Council and Nottinghamshire Pension Fund for the year ending 31 March 2018, we confirm that there were no relationships between KPMG LLP and Nottinghamshire County Council and Nottinghamshire Pension Fund, 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.

We have provided a detailed declaration in **Appendix 5** in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Section 151 officer for presentation to the Governance and Ethics Committee. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

ISA 260 requires us to communicate to you by exception 'audit matters of governance interest that arise from the audit of the financial statements' which include:

— Significant difficulties encountered during the audit;

— Significant matters arising from the audit that were discussed, or subject to correspondence with management;

— Other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process; and

— Matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. significant deficiencies in internal control; issues relating to fraud, compliance with laws and regulations, subsequent events, non disclosure, related party, public interest reporting, questions/objections, opening balances etc.).

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report 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

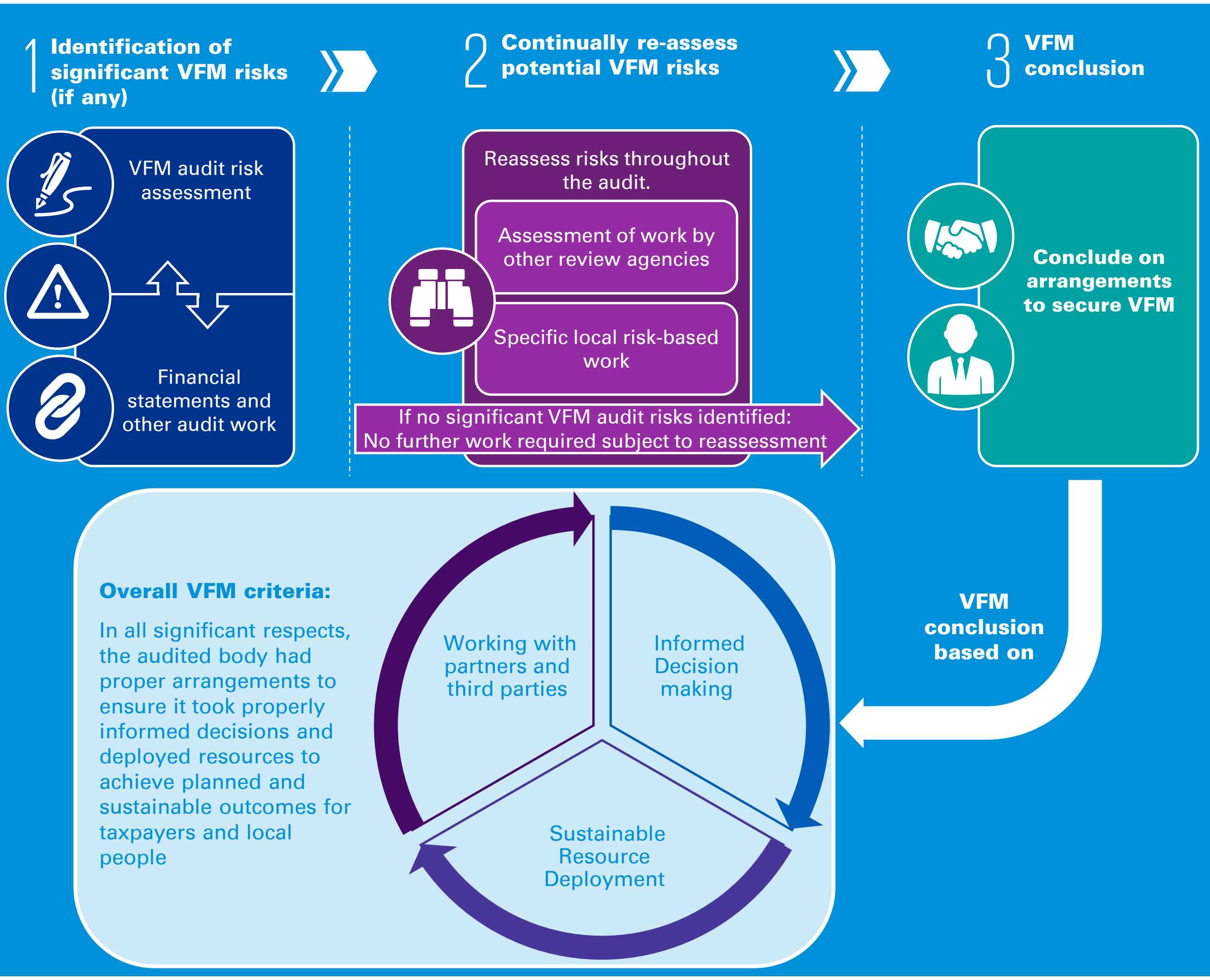
Our 2017-18 VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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 risk identified against the three sub-criteria. This directly feeds into the overall VFM criteria and our value for money opinion.

Applicability of VFM Risks to VFM sub-criteria			
VFM Risk	**Informed decision making**	**Sustainable resource deployment**	**Working with partner and third parties**
Medium Term Financial Planning	✓	✓	✓

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* we have identified one risk requiring specific audit attention and procedures to address the likelihood that proper arrangements are not in place to deliver value for money.

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 area identified, our work undertaken and the conclusions reached.

Medium Term Financial Planning

Risk:

The Authority continues to face similar financial pressures and uncertainties to those experienced by others in the local government sector. For 2017/18, the Authority has a balanced budget, but the updated Medium Term Financial Strategy 2018/19 to 2021/22 identifies a gap of £54.7m between 2018/19 and 2021/22, resulting from increasing cost pressures and reductions in grant funding. The Authority needs to have effective arrangements in place for managing its annual budget, and identifying and implementing sufficient savings and income measures to balance its medium term financial plan.

Our assessment and work undertaken:

We have undertaken the following procedures over this VFM risk:

- Reviewed the arrangements the Authority has in place to ensure financial resilience;
- Assessed arrangements for ensuring that savings plans have been achieved as planned, including any actions taken by the Authority when schemes do not deliver as expected; and
- Reviewed the Authority's arrangements in place to deliver services through partnerships, including the Sustainability and Transformation Partnership.

We have completed our assessment by:

- Regular liaison with the s151 officer, and key personnel;
- Meetings with Corporate Directors from key areas of the Authority, including Adult Social Care and Health, Children Families and Cultural Services, and Place;
- Review of the Medium Term Financial Strategy 2018/19 to 2021/22; and
- Review of 2017/18 outturn vs budget and 2018/19 budget.

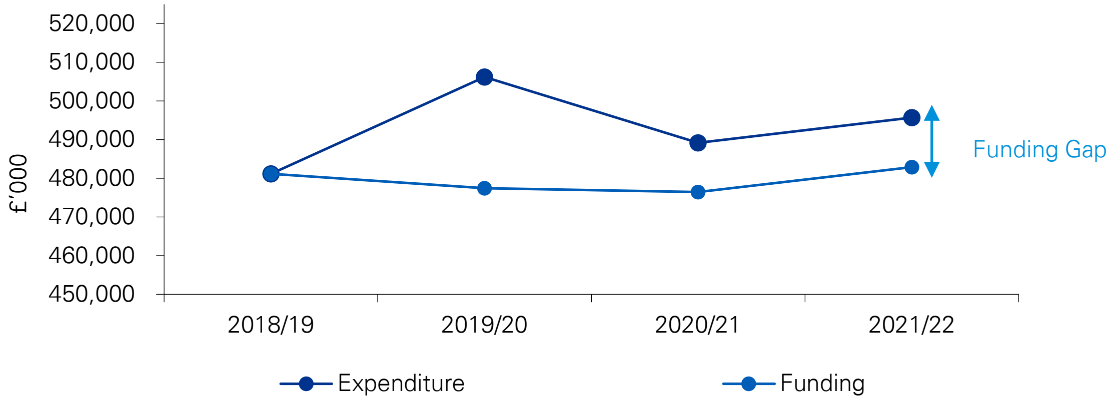
Our findings are summarised below:

- The Authority reported an underspend of £17.6m on its net expenditure budget for 2017/18, which increases the General Fund balance by £3.2m to £30.9m as of 31 March 2018. As a result the closing balance on the General Fund is £8.7m higher than the revised budget. The Authority is currently undertaking an exercise to fully understand the permanent or temporary nature of this underspend. Permanent underspends will be removed from future base budgets. The remaining temporary underspend will be used to fund specific future priorities and support the strategy required to meet the £54.2m shortfall in funding across the medium term.
- The Authority has set a balanced budget for 2018/19 with savings identified of £15.6m and use of planned reserves of £14.7m. The Authority has also revisited its assumptions contained in the Medium Term Financial Strategy 2018/19 to 2021/22 as part of the 2018/19 Budget process. Based on these assumptions the Authority is currently projecting a budget shortfall of £54.2m from 2019/20 to 2021/22 as shown on the graph over the page.

Specific value for money risk areas (cont.)

Significant VFM Risks (cont.)

Our assessment and work undertaken:



- Like most of local government, the Authority faces a challenging future driven by funding reductions and an increase in demand for services. This is further complicated by the uncertainty relating to the future of financing of local government, particularly business rate reform, fair funding review and the strategy for funding social care, as well as the more general uncertainties in relation to Brexit.
- The Authority have introduced a revised and more streamlined approach to strategic planning and performance management through the implementation of a new Planning and Performance Framework. Nevertheless the Authority needs make tough decisions ahead to deliver balanced budgets over the coming years, but also maintain strict budgetary control to minimise overspends and continue to monitor delivery of savings targets tightly.
- The Authority is proactive in developing relationships and working with third parties. These include the subsidiaries the Authority is working with, as well as Health Bodies. In addition, David Pearson (Corporate Director, Adult Social Care, Health and Deputy Chief Executive) is the lead officer for the Sustainability and Transformation Plan (STP) for Nottinghamshire. Nottinghamshire is part of a Public health and social care pilot based on integrated personal commissioning, which is described by NHS England as '*an entirely new proactive and joined-up way to care assessment and planning for those that need it most.*'

Appendices

Appendix 1:

Key issues and recommendations

Our audit work on the Authority's 2017-18 financial statements has identified three issues. 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: 0	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: 1	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: 2

No.	Risk	Issue & Recommendation	Management Response
1	2	An assessment of privileged user access rights within SAP identified a small number of potential segregation of duties conflicts that reduced the effectiveness of established change management processes; these were notified to the Authority ***Risk*** In specific circumstances, there is a risk that an individual member of staff is able to develop and implement a change within the live system, bypassing expected segregation of user roles within the system. ***Recommendation*** The Authority should amend user roles to enforce segregation of duties between roles allowing the development of changes and those that allow the release of changes into the live environment.	The small number of potential conflicts were mitigated to the satisfaction of KPMG during the Audit. The NCC support staff have a wide range of access due to their technical and functional support roles. Operationally, the segregation of duties is in place with the Competency Centre staff developing changes, and the ICT Basis staff processing changes. The roles for the Competency Centre staff will be reviewed in relation to restricting access to the processing of changes and therefore enforce segregation. ***Responsible Officer*** Nigel Carlisle Competency Centre Team Manager ***Implementation Deadline*** 31/08/2018

Key issues and recommendations (cont.)

No.	Risk	Issue & Recommendation	Management Response
2	3	Audit testing of user administration processes identified three instances where SAP user account access was not revoked in a timely manner. ***Risk*** Failure to revoke access to use accounts in a timely manner increases the risk of unauthorised access to systems and data. ***Recommendation*** Whilst we were able to mitigate the risk for Audit purposes by establishing the accounts had not been used after the user's leaving date, the Authority should review user administration processes to identify any opportunities for further improvement.	NCC will review the SAP user administration processes in conjunction with a recently procured software tool (ProfileTailor Dynamics) which offers new options relating to account management, with a view to ensuring access is evoked in a timely manner ***Responsible Officer*** Nigel Carlisle Competency Centre Team Manager ***Implementation Deadline*** 31/10/2018
3	3	Our assessment of system-enforced password settings for both SAP and Active Directory identified that they were not fully compliant with the Authority's password policy ***Risk*** Failure to fully comply with password policies may increase the risk of unauthorised access to Authority systems and data. ***Recommendation*** The Authority should review the password policies enforced within SAP & Active Directory and align them to the password policy	The NCC password policies and SAP capabilities will be reviewed in order to comply. ***Responsible Officer*** Nigel Carlisle Competency Centre Team Manager ***Implementation Deadline*** 31/08/2018

Appendix 2:

Follow-up of prior year recommendations

The Authority has implemented the recommendation raised through our previous audit work.

This appendix summarises the progress made to implement the recommendation identified in our *ISA 260 Report 2016/17.*

Number of recommendations that were	
Included in the original report	1
Implemented in year or superseded	1
Outstanding at the time of our audit	-

No.	Risk	Issue & Recommendation	Management Response	Status as at June 2018
1	1	We reviewed the general IT controls at the Authority, specifically looking at the controls over the SAP system. We noted the following exceptions: ▪ Several named individuals had been granted access to highly privileged profiles the use of which is discouraged by the software supplier SAP due to their powerful nature; ▪ A number of generic accounts exist within the live system that grant access to highly privileged transactions. The use of generic accounts reduces individual accountability for changes made and in the cases identified grant access to privileged profiles in SAP, which the software suppler SAP recommend are not accessible to users because of their privileged nature; ▪ An assessment of privileged user access rights also identified a number of potential segregation of duties conflicts that reduced the effectiveness of established change management processes; these were notified to the Authority; and ▪ Inadequate controls over the locking and unlocking of the system. We noted that the live system had recently been locked and that some logging functionalities had not been enabled during this time. This meant that we were unable to tell how long the system had been unlocked and how many times it had been locked and unlocked during the period under review.	The County Council has a support contract with CGI to ensure any issues with the SAP system which cannot be resolved by in-house resources are rectified. Access by CGI staff only occurs when issues have been logged by Business Support Centre (BSC) staff and detailed records of when this access is used and what is undertaken are maintained by the BSC. In terms of the specific recommendations, these have all been actioned. ***Responsible Officer*** Group Manager – Financial Strategy & Compliance Group Manger – Business Support Centre ***Implementation Deadline*** N/A – completed.	**Implemented** A new recommendation relating to opportunities to improve segregation of duties controls has been raised (see **Appendix 1**).

Appendix 2:

Follow-up of prior year recommendations

No.	Risk	Issue & Recommendation	Management Response	Status as at June 2018
1	1	(continued) ***Risk*** Although we were able to mitigate the impact of these exceptions on our overall assessment, it is imperative that any changes to the system, which includes the 'locking and unlocking' of the system is sufficiently logged. ***Recommendation*** The Authority should: • Review the users with privileged profile access and determine whether this level of access is appropriate; • Restrict the use of privileged transactions in line with guidance from the software provider SAP; • Where possible, all changes should be made through established change management processes without the system being unlocked (via STMS); and • Where changes require the system to be unlocked, this should be sufficiently documented and logged with an thorough audit trail.		

Materiality and reporting of audit differences

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

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

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

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

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

Materiality for the Authority's accounts was set at £18.6 million which equates to around 1.5 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Governance and Ethics 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 Governance and Ethics 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 £0.93 million for the Authority.

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

Materiality – Pension fund audit

The same principles apply in setting materiality for the Pension Fund audit. Materiality for the Pension Fund was set at £50 million which is approximately 1 percent of gross assets.

We design our procedures to detect errors at a lower level of precision, set at £2.5 million for 2017-18.

Appendix 4:

Required communications with the Governance and Ethics Committee

We have provided below at-a-glance summary of the information we are required to report to you in writing by International Standards on Auditing (UK and Ireland).

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 no adjusted material audit differences. See page 16 for details.
Unadjusted audit differences	We have identified no unadjusted audit differences
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 Governance and Ethics Committee	There were no matters to report arising from the audit that, in our professional judgment, 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 details of significant deficiencies identified, on pages 26 to 27. We communicated to management in writing all deficiencies in internal control over financial reporting of a lesser magnitude than significant deficiencies identified during the audit that had not previously been communicated.
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.
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	No matters to report. The engagement team and others in the firm, as appropriate, the firm and, when applicable, KPMG member firms have complied with relevant ethical requirements regarding independence. See **Appendix 5** 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 15.**
Significant matters discussed or subject to correspondence with management	There were no significant matters arising from the audit.

Declaration of independence

ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF NOTTINGHAMSHIRE COUNTY COUNCIL AND NOTTINGHAMSHIRE PENSION FUND

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;

— 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 an Audit Director not otherwise involved in your affairs.

We are satisfied that our general procedures support our independence and objectivity.

Declaration of independence (cont.)

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

Summary of fees

We have detailed the fees charged by us to the authority for professional services provided by us during the reporting period. 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	98,213	98,213
Audit of the Pension Fund	29,926	33,442
Total audit services	**128,139**	**131,655**
Non-audit services	6,000	6,000
Total Non Audit Services	**6,000**	**6,000**

No approval is required from PSAA for the non-audit services above as they are below the relevant threshold. In addition, we monitor our fees to ensure that we comply with the 70% non-audit fee cap set by the NAO.

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 table on the following page.

Appendix 5:

Declaration of independence (cont.)

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 £
Non-audit services			
Teachers Pension Return 2016/17 Local Transport Plan Major Projects return 2016/17 (Both performed in 2017/18 but relate to 2016/17	**Self-interest:** These engagements are entirely separate from the audit through separate contracts. In addition, the statutory audit fee scale rates were set independently to KPMG by the PSAA. Therefore, these engagements 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 work is auditing these grant returns. The returns have no impact on the main audit. Therefore this does not impact on our opinion and we do not consider that the outcome of this work threats to our role as external auditors. Consequently we consider we have appropriately managed this threat. **Management threat:** This work will be audit work only – all decisions are made by the Authority. **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 will draw on our experience in such roles to provide the Authority with a range of approaches but the scope of this work falls well short of any advocacy role. **Intimidation:** not applicable.	Fixed fee	£3,000 £3,000
Total			**£6,000**

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the Governance and Ethics Committee.

Appendix 5:

Declaration of independence (cont.)

Confirmation of audit independence

We confirm that as of the date of this report, in our professional judgment, 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 Governance and Ethics 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

The key contacts in relation to our audit are:

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We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Tony Crawley, the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers, by email to Andrew.Sayers@kpmg.co.uk. After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.