External Audit Plan 2017/2018

Northampton Borough Council

November 2018

Summary for Audit Committee

There are a number of challenges facing Northampton Borough Council (the "Authority" or "Council" or "NBC"), and this document sets out our assessment of risks which we consider relevant to the audit of the Authority's financial statements.

We also articulate risks which we have identified as part of your Value for Money (VFM) opinion, and explain how we intend to address these identified risks.

Our risk assessment takes into account the cumulative knowledge gained from the work which we have carried out as your external auditor over the past few years. This includes the adverse VFM conclusion which we issued in 2015/16 and the indicative adverse VFM conclusion for 2016/17.

The risk assessment is a continuous process, and we will update our audit plan and identified risks throughout the engagement in response to new developments at the Authority. In particular, we will take into account any further information arising from our work on the Authority's 2017/18 accounts and reports by external parties on the Authority's efforts to recoup lost monies in relation to the Northampton Town Football Club (NFTC) loan.

This audit plan would normally have been presented to the Audit Committee following our initial planning stages in January 2018. However, due to the on-going delays in the finalisation of the 2016/17 financial statements and completion of that audit, our work on the 2017/18 audit has been delayed as a result. As our work in respect of 2016/17 concludes, our materiality and risk assessment will be continually reviewed in light of our findings.

Summary for Audit Committee (cont.)

Financial statements

There are no significant changes to the Code of Practice on Local Authority Accounting ("the Code") in 2017/18, which provides stability in terms of the accounting standards the Authority need to comply with. Despite this, the deadline for the production and signing of the financial statements has been significantly advanced in comparison to year ended 31 March 2017.

With the delays experienced during the 2016/17 audit and with the audit not being completed as at July 2018, it was agreed the earlier deadline for 2017/18 would not be met. As such, an updated deadline of January 2019 has now been agreed.

Materiality

Materiality for planning purposes has been set at £1.3 million.

We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance and this has been set at £65,000.

Significant risks

We have completed our initial risk assessment. As this plan has been produced prior to the completion of the 2016/17 audit, we will revisited this assessment following conclusion of that audit. Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error have been identified as:

- **Valuation of Council Dwellings** – During 2016/17 audit, the Authority's external valuers valued Council Dwellings at a higher-than-expected value due to using the incorrect Social Housing discount factor (EUV-SH) for Northamptonshire. The difference in factors resulted in the Authority understating its Council Dwellings by £121.7 million. As a result of this, for 2017/18 Audit Council Dwellings is a separate significant risk.
- **Valuation of Other Land and Buildings** – Whilst the Authority operates a cyclical revaluation approach, the Code requires that all land and buildings be held at fair value. We will consider the way in which the Authority ensures that assets not subject to in-year revaluation are not materially misstated. During 2016/17 audit, we found the internal valuers did not have the capacity to complete a full valuation and that no formal written instructions were provided to the external valuers. In addition, there were issues found with the valuations provided by the valuers causing another external valuer to be involved.
- **Valuation of Investment Properties** – Whilst the Authority operates a cyclical revaluation approach, the Code requires that all land and buildings be held at fair value. We will consider the way in which the Authority ensures that assets not subject to in-year revaluation are not materially misstated. In prior year, we found there were issues in the valuation report received from Underwoods, the external valuer.
- **Pension 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 will review the processes in place to ensure accuracy of data provided to the Actuary and consider the assumptions used in determining the valuation.

Summary for Audit Committee (cont.)

Value for Money Arrangements work

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

- Delivery of Budgets;
- Governance Action Plan;
- NTFC loan and the wider loans system;
- Financial resilience in the local and national economy;
- Off-payroll working through an intermediary (IR35);
- Chief Executive Payment; and
- Contracts management

See pages 12 to 20 for more details

Logistics

Our team is:

- Andrew Cardoza – Director
- Daniel Hayward – Senior Manager
- Katie Scott – Manager
- Clementine Macliver – In-Charge

More details are in **Appendix 2**.

Our work will be completed in four phases and our key deliverables are this Audit Plan, an Interim Report and a Report to Those Charged With Governance as outlined on **page 23**.

Our scale fee for the 2017/18 audit is £80,775 see **page 22**. Our scale fee for 2016/17 was £80,775 although we have raised fee variations with the Authority which need to be approved by the PSAA. At the date of this report, additional fee for the 2016/17 audit was £150k.

Introduction

Background and Statutory responsibilities

This document supplements our Audit Fee Letter 2017/18 presented to you in April 2017, which also sets out details of our appointment by Public Sector Audit Appointments Ltd (PSAA).

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

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

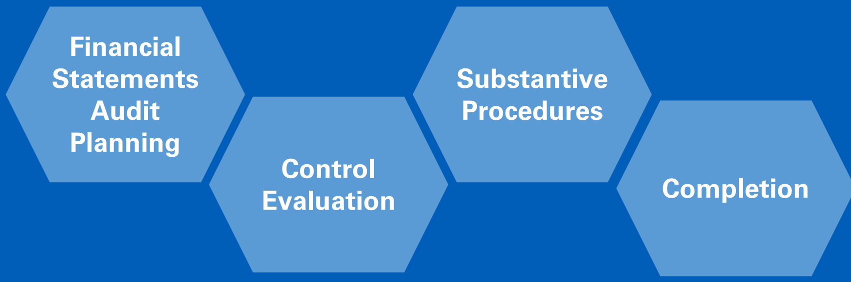
01 **Financial statements :**
Providing an opinion on your accounts. We also review the Annual Governance Statement and Narrative Report and report by exception on these; and

02 **Use of resources:**
Concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the value for money conclusion).

The audit planning process and risk assessment is an on-going process and the assessment and fees in this plan will be kept under review and updated if necessary. Any change to our identified risks will be reported to the Audit Committee.

Financial Statements Audit

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



Value for Money Arrangements Work

Our Value for Money (VFM) Arrangements work follows a five stage process which is identified below. Page 12 provides more detail on the activities that this includes. This report concentrates on explaining the VFM approach for 2017/18 and the findings of our VFM risk assessment.

Financial statements audit planning

Financial Statements Audit Planning

We have completed our audit planning work for the year, which involved the following key aspects:

- Determining our materiality level;
- Risk assessment;
- Identification of significant risks;
- Consideration of potential fraud risks;
- Identification of key account balances in the financial statements and related assertions, estimates and disclosures;
- Consideration of management's use of experts; and
- Issuing this audit plan to communicate our audit strategy.

Risk assessment

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

01

Management override of controls

Management is typically in a powerful position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.

02

Fraudulent revenue recognition

We do not consider this to be a significant risk for local authorities as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures.

Significant Risks

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

Risk 1:

Valuation of Council Dwellings

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. The Authority has an extensive property portfolio which requires valuation on a regular basis to reflect the service potential of these assets.

The valuation of council dwellings is a complex exercise which involves professional judgement of qualified valuation experts. There are significant estimates and judgements used by the Authority's valuer, and the valuation results are highly sensitive to these estimates and judgements. The valuation exercise is also linked to the estimates in relation to the useful economic lives of the buildings within the Authority's portfolio.

In 2015/16, the Authority's PPE totalled £548.9 million, which includes £421.8 million of council dwellings. The Authority experienced significant difficulty in the valuation process for council dwellings in 2016/17. We found that the Authority had used the incorrect social housing discount factor on two occasions, and a beacon review indicated that a small number of beacons were not representative of the Authority's housing stock.

In 2016/17, the Authority engaged with three separate valuers on council dwellings: its internal valuers who performed the initial valuation; Underwoods to review the use of "appropriateness of beacons"; and Bruton Knowles who performed the final valuation.

In concluding the on-going 2016/17 audit, we expect the final audited financial statements to include material audit adjustments. These arose from multiple incorrect iterations of valuer reports, all of which resulted in significant delays to the Authority's financial statements, which meant missing the statutory deadline by more than 10 months. There remains a risk that the Authority's council dwellings may be materially misstated due to incorrect processes and a lack of quality control over inputs into the financial statements.

Approach

We will review the approach that the Authority has adopted to assess the risk that assets not subject to valuation are not materially misstated and we will consider the robustness of that approach. We will also assess the risk of the valuation changing materially during the year.

We will undertake an assessment of the Authority's external valuer, Bruton Knowles. This will include a review of the valuer's approach, for consistency with the Authority's instructions and requirements, and assumptions made by the valuer that they are in line with local circumstances and market conditions. We have engaged our internal KPMG valuation specialist to undertake this work. Our work will also involve substantively testing inputs provided and agreeing valuation outputs to the fixed asset register.

We will consider movement in market indices between revaluation dates and year end to determine whether these indicate fair values have moved materially over that time.

In relation to those assets which have been revalued during the year we will assess the valuer's qualifications, objectivity and independence to carry out such valuations and review the methodology used (including testing the underlying data and assumptions).

Significant Risks

Risk 2:

Valuation of Other Land and Buildings

During the course of the 2016/17 audit, we identified that the valuation of 'other land and buildings' is a significant audit risk. The Authority had engaged the following valuers to carry out work on both other land and buildings and investment properties:

- internal valuers on 26 September 2016;
- Underwoods on 6 October 2016; and
- GVA in December 2017.

The engagement of Underwoods was due to the capacity constraints within the Estates team, with internal valuers leaving the Authority. From September 2017 there are no valuation specialists remaining with the Authority, creating a gap in both capacity and capability.

This was heightened by the departure of a key member of the Closedown team, which gave us concerns over continuity and on the oversight of the valuation process.

We found there were no formal instructions sent to Underwoods therefore we were not able to confirm that Underwoods had complied with the valuation request, or that the Authority had instructed Underwoods in line with the Code requirements and other applicable valuation and accounting standards.

GVA have been engaged to complete valuations for the 2017/18 year for both 'other land and buildings' and 'investment properties', following KPMG's approval of their methodology. However, there remains a risk that incomplete or inaccurate information is sent to the valuers to inform their revaluation (e.g classifications), and therefore incorrect methodologies are applied.

Likewise there remains a risk that the Authority's assets maybe materially misstated due to incorrect processes and a lack of quality control and review over inputs into the financial statements.

Approach

We will review the approach that the Authority has adopted to assess the risk that assets not subject to valuation are not materially misstated and we will consider the robustness of that approach. We will also assess the risk of the valuation changing materially during the year.

We will undertake an assessment of the Authority's external valuer, GVA. This will include a review of the valuer's approach, for consistency with the Authority's instructions and requirements, and assumptions made by the valuer that they are in line with local circumstances and market conditions. We have engaged our internal KPMG valuation specialist to undertake this work. Our work will also involve substantively testing inputs provided and agreeing valuation outputs to the fixed asset register.

We will consider movement in market indices between revaluation dates and year end to determine whether these indicate fair values have moved materially over that time.

In relation to those assets which have been revalued during the year we will assess the valuer's qualifications, objectivity and independence to carry out such valuations and review the methodology used (including testing the underlying data and assumptions).

We will also review that all assets reclassified to 'surplus assets' or 'assets held for sale' during the year have been valued and that valuations have been transacted appropriately on the Authority's balance sheet.

Significant Risks

Risk 3:

Valuation of Investment Properties

The Authority has a portfolio of investment property, the full portfolio of which requires valuation on an annual basis. Our work in 2016/17 identified that the assumptions and methodology used were not in line with RICS guidance and standard industry practice. For example, the Authority's valuers had included purchaser's costs within the value of the property, thus overstating the assets that were valued. We also noted that not all assets which were valued were transacted within the fixed asset register. Material adjustments were required.

GVA will carry out the 2017/18 valuations.

There is a risk that that incomplete or inaccurate information is sent to the valuers to inform their revaluation, and that the Authority's assets maybe materially misstated due to incorrect processes and a lack of quality control and review over inputs into the financial statements.

Approach

We will undertake an assessment of the Authority's external valuer, GVA. This will include a review of the valuer's approach, for consistency with the Authority's instructions and requirements, and assumptions made by the valuer that they are in line with local circumstances and market conditions. We have engaged our internal KPMG valuation specialist to undertake this work. Our work will also involve substantively testing inputs provided and agreeing valuation outputs to the fixed asset register.

Significant Risks

Risk 4:

Pension Liabilities

The net pension balance represents a material element of the Authority's balance sheet. The Authority is an admitted body of Northamptonshire 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 balance accounted for in the financial statements.

Approach

As part of our work we will review the controls that the Authority has in place over the information sent directly to the Scheme Actuary. We will also liaise with the auditors of the Pension Fund in order to gain an understanding of the effectiveness of those controls operated by the Pension Fund. This will include consideration of the process and controls with respect to the assumptions used in the valuation. We will also evaluate the competency, objectivity and independence of Hymans Robertson.

We will review the appropriateness of the key assumptions included within the valuation, compare them to expected ranges, and consider the need to make use of a KPMG Actuary. We will review the methodology applied in the valuation by Hymans Robertson.

In addition, we will review the overall Actuarial valuation and consider the disclosure implications in the financial statements.

Due to the delays in the audit of the 2017/18 financial statements, we will ensure that where available, actual figures are now being used to inform calculations, rather than estimates which may have been provided previously due to the faster closer timetable required for local authority accounts during the year.

Financial statements audit planning (cont.)

Materiality

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

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

For the Authority, materiality for planning purposes has been set at £1.3 million which equates to 0.5% percent of gross expenditure.

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

Prior Year Gross Expenditure: ££260.8m (2016/17: £**238.2**m)

Materiality

£1.3m

0.5% of Expenditure

(2016/17: £1.5m, 0.6%)

£65,000
Misstatements reported to the audit committee
(2016/17: £75,000)

£845,000
Procedures designed to detect individual errors
(2016/17: £1.1m)

£1.3m
Materiality for the financial statements as a whole
(2016/17: £1.5m)

Financial statements audit planning (cont.)

Reporting to the Audit Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work.

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

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £65,000.

If management has 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.

We will report:

Non-Trivial corrected audit misstatements

Non-trivial uncorrected audit misstatements

Errors and omissions in disclosure

(Corrected and uncorrected)

Value for money arrangements work

VFM audit approach

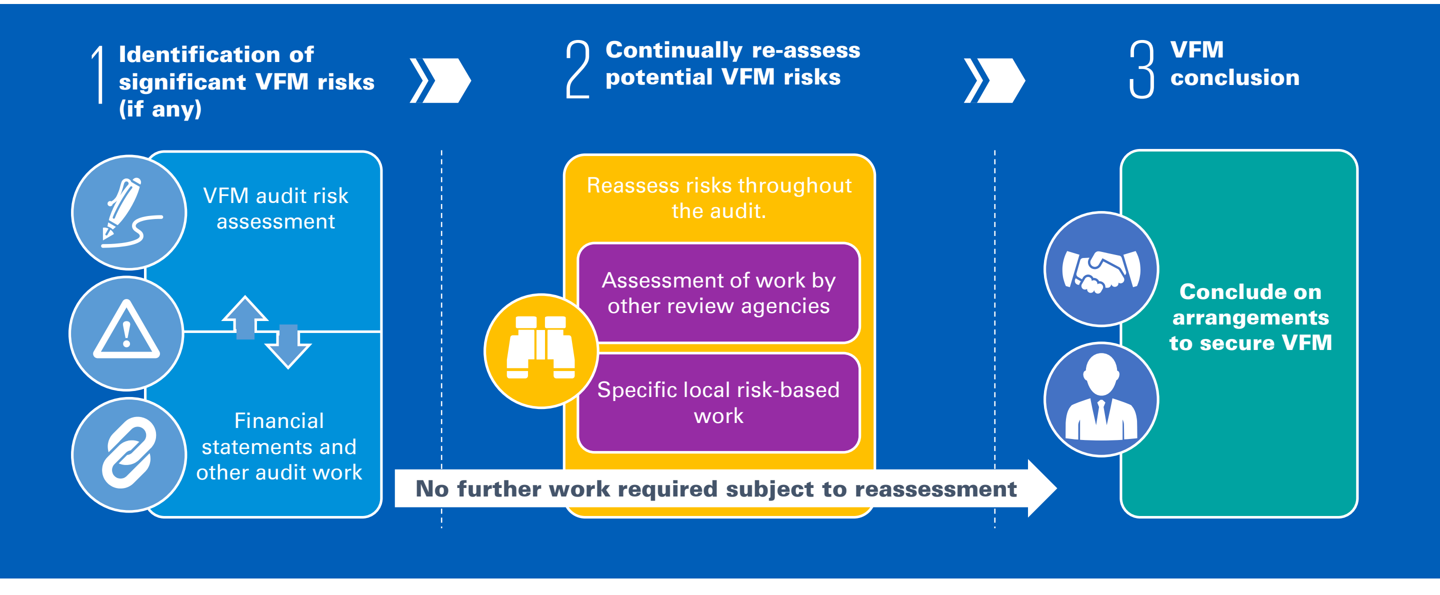
The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

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.'

Overall criterion

In 2016/17 we issued a qualified value for money opinion due to concluding that the Authority had not 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 VFM approach is fundamentally unchanged from that adopted in 2016/17 and the process is shown in the diagram below. The diagram overleaf shows the details of the sub-criteria for our VFM work.



Value for money arrangements work (cont.)

Value for Money sub-criterion

Informed decision making

Proper arrangements:

- Acting in the public interest, through demonstrating and applying the principles and values of sound governance.
- Understanding and using appropriate and reliable financial and performance information to support informed decision making and performance management.
- Reliable and timely financial reporting that supports the delivery of strategic priorities.
- Managing risks effectively and maintaining a sound system of internal control.

Sustainable resource deployment

Proper arrangements:

- Planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions.
- Managing and utilising assets to support the delivery of strategic priorities.
- Planning, organising and developing the workforce effectively to deliver strategic priorities.

Working with partners and third parties

Proper arrangements:

- Working with third parties effectively to deliver strategic priorities.
- Commissioning services effectively to support the delivery of strategic priorities.
- Procuring supplies and services effectively to support the delivery of strategic priorities.

Value for money arrangements work (cont.)

VFM audit stage

VFM audit risk assessment

Linkages with financial statements and other audit work

Identification of significant risks

Audit approach

We consider the relevance and significance of the potential business risks faced by all local authorities, and other risks that apply specifically to the Authority. These are the significant operational and financial risks in achieving statutory functions and objectives, which are relevant to auditors' responsibilities under the *Code of Audit Practice.*

In doing so we consider:

- The Authority's own assessment of the risks it faces, and its arrangements to manage and address its risks;
- Information from the Public Sector Auditor Appointments Limited VFM profile tool;
- Evidence gained from previous audit work, including the response to that work; and
- The work of other inspectorates and review agencies.

Audit approach

There is a degree of overlap between the work we do as part of the VFM audit and our financial statements audit. For example, our financial statements audit includes an assessment and testing of the Authority's organisational control environment, including the Authority's financial management and governance arrangements, many aspects of which are relevant to our VFM audit responsibilities.

We have always sought to avoid duplication of audit effort by integrating our financial statements and VFM work, and this will continue. We will therefore draw upon relevant aspects of our financial statements audit work to inform the VFM audit.

Audit approach

The Code identifies a matter as significant *'if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public. Significance has both qualitative and quantitative aspects.'*

If we identify significant VFM risks, then we will highlight the risk to the Authority and consider the most appropriate audit response in each case, including:

- Considering the results of work by the Authority, inspectorates and other review agencies; and
- Carrying out local risk-based work to form a view on the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources.

Value for money arrangements work (cont.)

VFM audit stage

Assessment of work by other review agencies, and Delivery of local risk based work

Audit approach

Depending on the nature of the significant VFM risk identified, we may be able to draw on the work of other inspectorates, review agencies and other relevant bodies to provide us with the necessary evidence to reach our conclusion on the risk.

We will also consider the evidence obtained by way of our financial statements audit work and other work already undertaken.

If evidence from other inspectorates, agencies and bodies is not available and our other audit work is not sufficient, we will need to consider what additional work we will be required to undertake to satisfy ourselves that we have reasonable evidence to support the conclusion that we will draw. Such work may include:

– Additional meetings with senior managers across the Authority;

– Review of specific related minutes and internal reports;

– Examination of financial models for reasonableness, using our own experience and benchmarking data from within and without the sector.

Concluding on VFM arrangements

Audit approach

At the conclusion of the VFM audit we will consider the results of the work undertaken and assess the assurance obtained against each of the VFM themes regarding the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources.

If any issues are identified that may be significant to this assessment, and in particular if there are issues that indicate we may need to consider qualifying our VFM conclusion, we will discuss these with management as soon as possible. Such issues will also be considered more widely as part of KPMG's quality control processes, to help ensure the consistency of auditors' decisions.

Reporting

Audit approach

On the following page, we report the results of our initial risk assessment.

We will report on the results of the VFM audit through our ISA 260 Report. This will summarise any specific matters arising, and the basis for our overall conclusion.

If considered appropriate, we may produce a separate report on the VFM audit, either overall or for any specific reviews that we may undertake.

The key output from the work will be the VFM conclusion (i.e. our opinion on the Authority's arrangements for securing VFM), which forms part of our audit report.

Value for money arrangements work (cont.)

Significant VFM Risks

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

Risk 1:

Governance Action Plan

The Authority's internal auditors, PwC, issued a report in December 2016 on the Authority's Risk Management Policy and framework and to advise the Council on best practice. This was in response to the Northampton Town Football Club (NTFC) loan loss, totalling £12.2 million to date. In response to the PwC report, the Authority developed a Governance Action Plan. This is a fundamental document which contains all 11 recommendations made within PwC's report. There is a risk that issues and recommendations made within the report are not fully actioned and implemented by the Authority.

In 2016/17 we obtained the Authority's Governance Action Plan and reviewed reported progress against this Plan. We have documented how the Authority measures and evaluates performance against each action, and assess this against supporting documentation. As of 31 August 2017, the Authority recorded that 22 actions had been implemented (46%), whilst 21 had been partially implemented (44%) and a further 4 (8%) not implemented, and 1 (2%) to be confirmed.

Whilst we recognise that many of these actions have not yet passed their due date, in reviewing the arrangements in place during the 2016/17 financial year, it is clear that during this period there was an insufficiently systematic, robust, and objective governance process, and framework in place at the Authority.

Approach

We will obtain the Authority's Governance Action Plan and review reported progress against this plan. We will document how the Authority measures and evaluates performance against each action, and assess this against supporting documentation. We will also assess whether an gaps in control / governance remain which would impact our VFM conclusion.

VFM sub-criterion

This risk is related to the following Value For Money sub-criteria:

— Informed decision-making;

Value for money arrangements work (cont.)

Risk 2:

NTFC loan and the wider loans system

In 2015/16, we issued an adverse conclusion on the Authority's arrangements to secure value for money. We were not satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to loans is adequate. A recommendation was raised during our 2016/17 audit regarding the controls and processes for issuing loans, due to finding that there is no systematic formalised system of recording or documenting the due diligence process, or results from the loan approval process. In addition, we came to the conclusion the accountability and decision-making process is not sufficiently robust. Subsequent to the loss of £10.22 million, the Authority has approved up to £950,000 to be spent on recovering the lost monies.

Approach

Our work will focus on how the Authority has achieved value for money in relation to the additional funds spent on recovering the loan. We will consider actions taken to date on the recovery of the lost monies to NTFC.

Our work will also consider the Authority's wider arrangements in monitoring the repayments of Authority-issued loans and the process in which the Authority captures potential loan issues. We will link this with our work on the Authority's financial statements.

VFM sub-criterion

This risk is related to the following Value For Money sub-criteria:

— Informed decision-making;

— Sustainable resource deployment; and

— Working with partners and third parties

Value for money arrangements work (cont.)

Risk 3:

Financial resilience in the local and national economy

Like most of local government, Northampton Borough Council faces a challenging future driven by funding reductions and an increase in demand for services. At a local level, this is compounded by the County Council's financial difficulties.

For 2017/18, the Authority set a net budget of £29.1 million, which includes the requirement to achieve £2.8 million of savings during the financial year, being a mixture of additional income generation (£683k) and reduced expenditure from general efficiencies (£1.6 million), economic growth (£172k) and other technical savings including debt financing (£282k).

Over the subsequent years, the Authority has set an overall net budget requirement which increases from £29.1 million in 2017/18 to £32.5 million in 2021/22.

Feeding into the budget, the Authority has assumed a decrease in Revenue Support Grant from Central Government from £1.8 million next financial year to zero funding from 2019/20 onwards. Additionally funding from the New Homes Bonus reduces from £4.2 million in 2017/18 to £2.1 million by 2021/22. However, it is worth noting that the Authority has budgeted based on the assumption that funding from the Business Rates Retention Scheme will continue to increase during the period, from £7.6 million to £8.1 million by the end of the Medium Term Financial Plan. There is a risk attached to this due to the uncertainty provided by Central Government as to how this scheme will operate going forward and the Authority needs to ensure that budgeted assumptions are based on the latest information available to them and updated accordingly as the future of the Scheme is debated.

The financial pressure on the Authority is therefore likely to increase over the coming years and it is imperative that work continues to identify savings well in advance of the most difficult periods within the Medium Term Financial Plan, most especially savings which may require initial investment and a longer lead time to realise their benefits. The Authority has a positive track record of delivering savings, but this will only get more difficult. The Medium Term Financial Plan only detailed savings predicted up until 2020/21, and over this period a total of £7.5 million have been included in the budgets, although the Authority has set far higher targets of £21.9 million. This leaves unidentified savings of £14.4 million from 2018/19 onwards.

Approach

We will review the process for the Authority setting cost saving plans for 2017/18 and for future years. This will include understanding the processes behind designing cost saving proposals, the due diligence undertaken in calculating predicted savings as well as understand the associated risks of delivery, alongside the linked financial governance processes including in-year monitoring and reporting of individual projects.

We will also review the Authority's retrospective review of cost saving plans, to ensure that where partial or non-delivery occurs, lessons are learnt to ensure that future saving plans are more robustly constructed, or that risks are more clearly identified, articulated and / or mitigated at an earlier stage.

VFM sub-criterion

This risk is related to the following Value For Money sub-criteria:

— Informed decision-making;

— Sustainable resource deployment; and

— Working with partners and third parties

Value for money arrangements work (cont.)

Risk 4:

Off-payroll working through an intermediary (IR35)

Following the Finance Bill 2017, the Government introduced revised legislation relating to off-payroll working in the public sector. The measure applies to payments made on or after 6 April 2017, but also applies to contracts entered into before that date.

The off-payroll working rules are in place to make sure that, where an individual would have been an employee if they were providing their services directly, they pay broadly the same tax and National Insurance contributions (NICs) as an employee.

- Public Sector authorities will be responsible for identifying and reviewing the employment status of all workers engaged through personal service intermediaries (referred to throughout as Personal Service Companies("PSC")) including those provided via an agency.
- Where, in the absence of the PSC, the worker is deemed to be an employee of the Public Sector Council, it, (or the agency) is required to calculate the deemed payment being made to the worker.
- Account for PAYE and National Insurance (employee and employer) to HMRC on the deemed payment.
- Financial sanctions will be applied where the legislation is not applied or applied incorrectly e.g. where employment status is incorrectly determined HMRC will collect any underpaid tax and NIC from the Public Sector Council.

HMRC is committed to enforcing the new rules and has set up an employment status and intermediaries team to review the arrangements.

Approach

As part of our approach, we will review the policies and procedures put in place by the Authority in order to ensure compliance with IR35 legislation.

In particular we will review the process for identifying potential Personal Service Companies during the procurement and contracting stage with new suppliers, as well as the retrospective review of arrangements in place before 6 April 2017.

We will especially review arrangements where an individual was engaged via a Personal Service Company after previously having been directly employed by the Authority, and the value for money considerations taken into account and evidenced during this process.

Where identified, we will review a sample of current and historical arrangements to ensure relevant tax and legal considerations were appropriately undertaken, alongside value for money considerations relating to the nature of the engagement.

We will also review the on-going monitoring, reporting and oversight of these arrangements by the Authority to ensure regulatory compliance.

VFM sub-criterion

This risk is related to the following Value For Money sub-criterion:

- Working with partners and third parties

Value for money arrangements work (cont.)

Risk 5:

Chief Executive payment

The Authority's previous Chief Executive departed the organisation in July 2017. The Chief Executive also acts in a statutory role as the Head of Paid Service. There is a risk that the terms and conditions of the departure, including any exit package, did not provide value for money to the Authority.

Approach

We will review the circumstances surrounding the departure of the Chief Executive in July 2017. We will review any payments made to the Chief Executive on leaving the Authority, and associated documentation in order to ensure that appropriate procedures and governance arrangements were followed (including compliance with legislation) to ensure effective arrangements were in place to achieve value for money.

We will also review the process put in place by the Authority following the Chief Executive's departure to ensure that statutory roles (including the Section 151 Officer) were appropriately filled during any gap in appointment.

As part of our standard audit approach, we will also review exit packages for other staff leaving the Authority in the year, including those made through redundancy or early retirement.

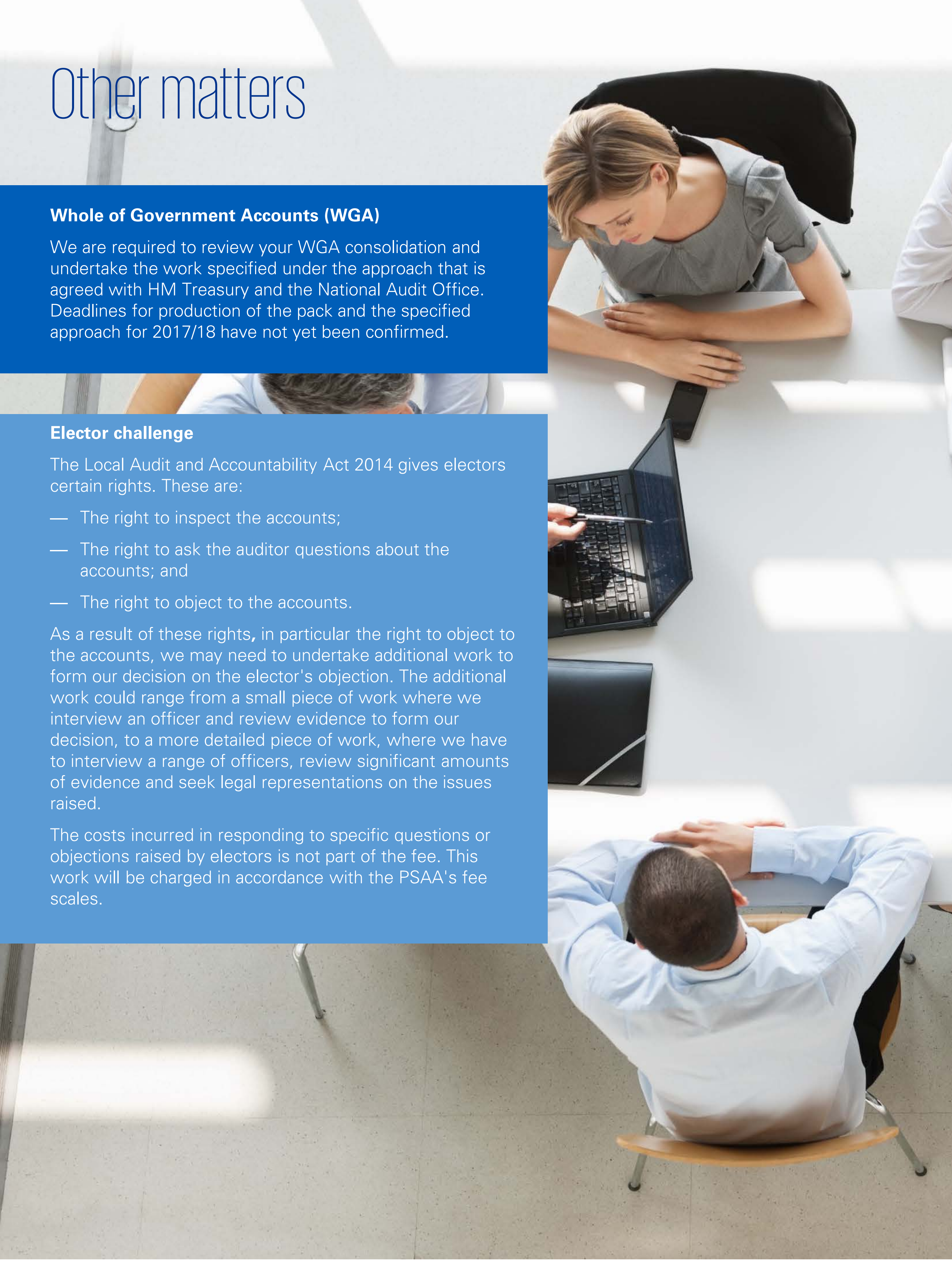
We will also review the disclosures and related narrative provided in the financial statements by the Authority in order to ensure they are appropriate and compliant with guidance

VFM sub-criterion

This risk is related to the following Value For Money sub-criterion:

— Informed decision-making; and

— Working with partners and third parties



Other matters

Whole of Government Accounts (WGA)

We are required to review your WGA consolidation and undertake the work specified under the approach that is agreed with HM Treasury and the National Audit Office. Deadlines for production of the pack and the specified approach for 2017/18 have not yet been confirmed.

Elector challenge

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

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

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

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

Other matters

Reporting and communication

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

Independence and Objectivity

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

Audit fee

Our Audit Fee Letter 2017/2018 presented to you in April 2017 first set out our fees for the 2017/2018 audit. This letter also set out our assumptions.

Should there be a need to charge additional audit fees then this will be agreed with the s.151 Officer and PSAA. If such a variation is agreed, we will report that to you in due course.

The planned audit fee for 2017/18 is **£80,775**, in line with 2016/17 (£80,775).

However, given the fact that the NBC audit is a High Risk audit (hence additional substantive audit testing work will need to be undertaken), extra IT work (as a result of the issues encountered with the asset management system), extra valuations work, and the issues encountered on the 2016/17 audit to name a few examples; then we need to ensure Officers and Members are aware that this additional work will result in extra costs and hence fee charged. As always any such extra cost/fee will be discussed and agreed with Senior Officers and Members.

In respect of the on-going 2016/17 audit, we have so far raised fee variations / overruns to date of £150k, (as of 5 July 2018) in light of the additional work required relating to the issues previously flagged in respect of PPE, and further delays encountered since our initial fieldwork in July 2017. These have been discussed and agreed with Senior Officers and the Section 151 Officer. Once the audit is complete, our final fee variation will be discussed and agreed with the Council. This will then be subject to approval by the PSAA.

Appendix 1:

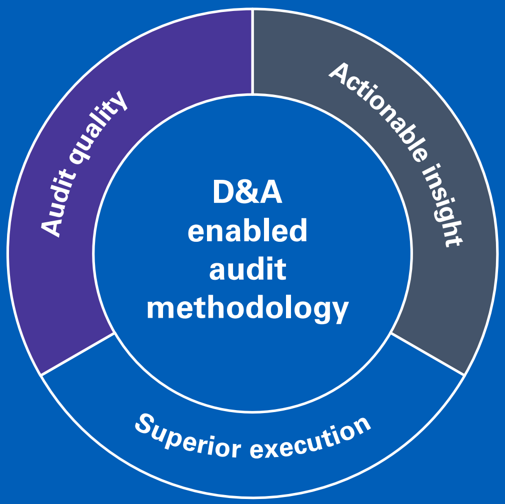
Key elements of our financial statements audit approach

Driving more value from the audit through data and analytics

Technology is embedded throughout our audit approach to deliver a high quality audit opinion. Use of Data and Analytics (D&A) to analyse large populations of transactions in order to identify key areas for our audit focus is just one element. Data and Analytics allows us to:

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

We anticipate using data and analytics in our work around key areas such as accounts payable, payroll and journals.



Appendix 1:

Key elements of our financial statements audit approach (cont.)

Audit workflow

Planning

- Determining our materiality level;
- Risk assessment;
- Identification of significant risks;
- Consideration of potential fraud risks;
- Identification of key account balances in the financial statements and related assertions, estimates and disclosures;
- Consideration of managements use or experts; and
- Issuing this audit plan to communicate our audit strategy.

Control evaluation

- Understand accounting and reporting activities;
- Evaluate design and implementation of selected controls;
- Test operating effectiveness of selected controls; an
- Assess control risk and risk of the accounts being misstated.

Substantive testing

- Plan substantive procedures;
- Perform substantive procedures; and
- Consider if audit evidence is sufficient and appropriate.

Completion

- Perform completion procedures;
- Perform overall evaluation;
- Form an audit opinion; and
- Audit Committee reporting.

Appendix 2:

Audit team

Your audit team has been drawn from our specialist public sector assurance department. Our audit team were all part of the Northampton Borough Council audit last year.

Andrew Cardoza
Director

E: Andrew.Cardoza@kpmg.co.uk

'My role is to lead our team and ensure the delivery of a high quality, valued added external audit opinion. I will be the main point of contact for the Audit Committee and Chief Executive.'

Daniel Hayward
Senior Manager

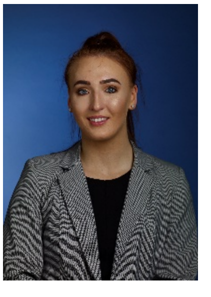
E: Daniel.Hayward@kpmg.co.uk

'I provide quality assurance for the audit work and specifically any technical accounting and risk areas. I will work closely with Andrew to ensure we add value. I will liaise with the Section 151 Officer and other Executive Directors.'

Katie Scott
Manager

E: Katie.Scott@kpmg.co.uk

'I too will provide quality assurance for the audit work and technical accounting and risk areas. I will work closely with Clementine to deliver the on-site work. I will liaise with the Section 151 Officer and other Executive Directors.'



Clementine Macliver
In-Charge

E: Clementine.Macliver@kpmg.co.uk

'I will be responsible for the on-site delivery of our work and will supervise the work of our audit assistants.'

Appendix 3:

Independence and objectivity requirements

ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF NORTHAMPTON BOROUGH COUNCIL

Professional ethical standards require us to provide to you at the planning stage 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 Ltd's ('PSAA's') Terms of Appointment relating to independence and the requirements of the FRC Ethical Standard and General Guidance Supporting Local Audit (Auditor General Guidance 1 – AGN01) issued by the National Audit Office ('NAO').

This Appendix 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 a partner not otherwise involved in your affairs.

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

Appendix 3:

Independence and objectivity requirements (cont.)

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.

Andrew Cardoza

KPMG LLP

KPMG LLP

kpmg.com/uk

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 Andrew Cardoza, 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.

CREATE: CRT086281A