



External Audit Report 2015/16

**London Borough of Hammersmith
and Fulham**

—
2 September 2016



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The contacts at KPMG in connection with this report are:

Andrew Sayers
Partner

Tel: 020 7694 8981
andrew.sayers@kpmg.co.uk

Jennifer Townsend
Senior Manager

Tel: 020 7311 1368
jennifer.townsend@kpmg.co.uk

Antony Smith
Pension Fund Manager

Tel: 020 7311 2355
antony.smith@kpmg.co.uk

Sarah McKean
Assistant Manager

Tel: 077 8538 1142
sarah.mckean@kpmg.co.uk

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. Public Sector Audit Appointments issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Andrew Sayers, the engagement lead to the Authority and the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, who will try to resolve your complaint. 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 3H.



Section one: Introduction



This document summarises:

- The key issues identified during our audit of the financial statements for the year ended 31 March 2016 for both the Authority and its Pension Fund; and
- Our assessment of the Authority's arrangements to secure value for money.

Scope of this report

This report summarises the key findings arising from:

- Our audit work at LBHF ('the Authority') in relation to the Authority's 2015/16 financial statements and those of the Local Government Pension Scheme it administers ('the Fund'); and
- The work to support our 2015/16 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

Financial statements

Our *External Audit Plan 2015/16*, presented to you in June 2016, set out the four stages of our financial statements audit process.



This report focuses on the second and third stages of the process: control evaluation and substantive procedures. Our on site work for this took place during March and July 2016.

We are now in the final phase of the audit, the completion stage. Some aspects of this stage are also included in this report.

VFM Conclusion

Our External Audit Plan 2015/16 explained our risk-based approach to VFM work. We have now completed the work to support our 2015/16 VFM conclusion. This included:

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

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our audit work in relation to the 2015/16 financial statements of the Authority and the Pension Fund.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1. We have also reviewed your progress in implementing prior recommendations.

Acknowledgements

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



Section two: Headlines



<p>We are aiming to issue our opinion on the Authority's financial statements by 30 September 2016.</p> <p>However, there are two potentially significant queries to resolve in relation to the Pension Fund. If these are not resolved by the 30 September 2016 we would not be in a position to sign the Authority's financial statements, which incorporate the Pension Fund financial statements.</p> <p>In relation to the Authority's financial statement themselves we anticipate issuing an unqualified audit opinion. The position as regards the Pension Fund is dependent upon resolving the issues outlined on this page.</p>	<p>Proposed audit opinion</p>	<p>We anticipate issuing an unqualified audit opinion on the Authority's financial statements themselves. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.</p>
<p>Pension Fund audit</p>	<p>Work on the audit of the Pension Fund is ongoing. There are two areas, noted below, where issues have arisen requiring further work:</p> <ul style="list-style-type: none"> — Resolution of a significant number of queries and potential errors in the completeness and accuracy of the data and information supporting the contributions and pensions values in the Fund's financial statements — Obtaining appropriate support for the valuations of level 2 and 3 assets from fund managers with an overall value of £245 million <p>These matters will need to be resolved in order for us to finalise our work. Whilst we anticipate this should be completed by 30 September 2016 there is a risk this may not be achieved. As the Pension Fund financial statements form part of the overall Authority financial statements, any delay in the the finalisation of the Pension Fund audit would delay our overall opinion on the Authority's financial statements.</p> <p>We will provide an oral update to the Audit, Pension and Standards Committee at the meeting on 13 September 2016.</p>	
<p>Audit adjustments</p>	<p>There have been a number of narrative adjustments throughout the accounts and accompanying notes. Our audit has identified a total of three audit adjustments greater than £600K which require reporting.</p> <ol style="list-style-type: none"> 1. Trade Waste invoices of £2.1m for 2016/17 were issued in March 2016 creating a debtor balance on the AR system; in order to account for the income in the correct year a creditor (receipt in advance) was created. This should have instead been a credit adjustment to Debtors. 2. The Capital Ambition accounts were finalised at the end of 2014/15 and a nil balance carried forward but due to incorrect coding and mapping of this net nil position a debtor and creditor for £1.8m were created. 3. A third immaterial amount of (£0.4m) was also identified in our testing and corrected by management. 4. An additional adjustment of (£1.3m) to debtors and creditors as a result of the remapping exercise. <p>The impact of these adjustments is to decrease the gross balance of Debtors and Creditors on the balance sheet by £2.2 million (less than 0.2% of net assets), but do not impact the balance on the general fund and HRA account as at 31 March 2016</p> <p>We have included a full list of significant audit adjustments at Appendix two. All of these were agreed with officers and adjusted by the Authority. We have raised a recommendation in relation to the matters highlighted above, which is summarised in Appendix one.</p>	

Section two

Headlines (cont.)



<p>We have noted the continued high quality of the accounts and the supporting working papers. Officers dealt efficiently with audit queries. Difficulties related to managed services implementation have been mitigated to ensure financial reporting processes were adequate.</p>	<p>Key financial statements audit risks</p>	<p>We review risks to the financial statements on an ongoing basis and tailor our audit procedures accordingly. In addition to the rebuttable presumption of the fraud risk from revenue recognition, we identified the following key financial statement audit risks in our 15/16 External audit plan issued in June 2016.</p> <ul style="list-style-type: none"> — Management override of controls; — Valuation of Property, Plant and Equipment; and — Managed Services implementation (affecting Cash, Debtors, Creditors, Journals and Payroll). <p>We have worked with officers throughout the year to discuss these audit risks. Our detailed findings are reported in section 3 of this report. There were several matters arising related to managed services implementation, specifically around the processing of journal transactions and the matching of debtors/creditors, which are summarised in Appendix one. We have agreed one high priority recommendation over the visibility and assurance of controls operating at the service organisation.</p>
	<p>Accounts production and audit process</p>	<p>We received complete draft accounts by 30 June 2016 in accordance with the DCLG deadline. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code.</p> <p>We have noted the continued high quality of the accounts and the supporting working papers. Officers dealt efficiently with audit queries.</p> <p>The Authority has implemented the majority of the recommendations in our <i>ISA 260 Report 2014/15</i> relating to the financial statements. Due to prioritisation of the managed services implementation, our recommendation to implement an asset management system has not been implemented. Our recommendation to increase scrutiny over politically sensitive disclosures has been actioned; however, we found additional disclosure errors in the current year's accounts.</p> <p>Managed services implementation has presented a number of well documented challenges during the year. With regards to the accounts production process, the Authority has implemented additional year end measures to provide officers and members with assurance that the processes in place for the production of the accounts were adequate and supported by good quality working papers. This included retaining additional finance staff, performing additional assurance procedures over the year end accounts, and having an external review of the accounts undertaken prior to publication.</p> <p>As in previous years, we will debrief with the Finance team to share views on the final accounts audit. Hopefully this will lead to further efficiencies in the 2016/17 audit process. In particular we would like to thank Authority Officers who were available throughout the audit visit to answer our queries.</p>



<p>We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion.</p> <p>At the date of this report our audit of the financial statements is substantially complete for the Authority, but we have potentially significant queries in relation to the Pension Fund.</p> <p>You are required to provide us with representations on specific matters such as your going concern assertion and whether the transactions in the accounts are legal and unaffected by fraud.</p> <p>We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.</p>	<p>VFM conclusion and risk areas</p>	<p>We did not identify any specific VFM risks in our External audit plan 2015/16 issued in June 2016. However, we identified three VFM areas of audit focus for our year end procedures, including:</p> <ul style="list-style-type: none"> — Managed Services implementation; — Procurement and contract management; and — Sustainable resource deployment. <p>Our detailed findings are reported in section 4 of this report. There are no matters of any significance arising as a result of our audit work on these VFM focus areas.</p> <p>We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2016.</p>
<p>Completion</p>	<p>At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas:</p> <ul style="list-style-type: none"> — Pension fund audit (see above) — Subsidiary audits – Wormwood Scrubs and HF Development Ltd. — Whole of Government Accounts (WGA) <p>The last two items would typically be outstanding at this stage, although we note that the WGA will need to be completed to enable us to issue our certificate closing the audit.</p> <p>In addition we will need to complete our normal completion procedures including agreement of the final set of financial statements, receipt of the representation letter and completion of the post balance sheet event review.</p> <p>You are required to provide us with representations on specific matters such as your going concern assertion and whether the transactions in the accounts are legal and unaffected by fraud. We provided a draft of this representation letter to the Section 151 Officer on 30 August 2016. We draw your attention to the requirement in our representation letter for you to confirm to us that you have disclosed all relevant related parties to us. We are asking management to provide specific representations on the following:</p> <p>We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.</p>	



Section three: Financial Statements

Proposed opinion and audit differences



Our audit has identified a total of two audit adjustments which require reporting with a net value of £2.2 million.

The impact of these adjustments is to decrease the gross balance of Debtors and Creditors on the balance sheet by £2.2 million, but will have £nil effect on the balance on the general fund and HRA account as at 31 March 2016.

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Audit, Pensions, and Standards Committee on 13 September 2016.

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 materiality (see Appendix two for more information on materiality) level for this year's audit was set at £12 million. Audit differences below £600,000 are not considered significant.

Our audit identified a total of two significant audit differences, which we set out in Appendix Two. It is our understanding that these will be adjusted in the final version of the financial statements. An additional immaterial audit difference will also be corrected. As a result of these identified misstatements, we have also projected a possible additional misstatement onto the population, which does not require adjustment by management. This is detailed further in Appendix Two.

The tables on the right illustrate the total impact of audit differences on the Authority's movements on the General Fund and HRA for the year and balance sheet as at 31 March 2016.

There is no net impact on the General Fund and HRA as a result of audit adjustments; however, the Current Assets and Current Liabilities balance at 31 March 2016 will decrease by £2.2 million. This is the result of the following amendments:

- Overstatement of Receipts in Advance/Debtors - £2.1 million
- Non-Matching of Debtor/Creditor - £1.8 million
- Incorrect Mapping of Agency creditor – (£0.4 million)
- Additional adjustment from remapping exercise – (£1.3 million)

Balance sheet as at 31 March 2016			
£m	Pre-audit	Post-audit	Ref (App.2)
Property, plant and equipment	1,807	1,807	-
Other long term assets	92	92	-
Current assets	446	444	Dr/Cr
Current liabilities	(208)	(206)	Dr/Cr
Long term liabilities	(741)	(741)	-
Net worth	1,395	1,395	
General Fund	(19)	(19)	-
Other usable reserves	(239)	(239)	-
Unusable reserves	(1,137)	(1,137)	-
Total reserves	(1,395)	(1,395)	

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 2015/16 ('the Code'). We understand that the Authority will be addressing these where significant.

Proposed opinion and audit differences (cont.)



We have a number of potentially significant queries that need to be resolved in relation to the Pension Fund.

If they are all resolved to our satisfaction, we would anticipate issuing an unqualified audit opinion. However, at this stage it is not yet clear that this will be complete when the Statement of Accounts is due to be approved by the Audit, Pensions, and Standards Committee on 13 September 2016.

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

Pension fund audit

For the audit of the Fund we used a higher materiality level of £17 million. Audit differences below £850,000 are not considered significant.

Our audit of the Fund also has not yet identified any significant misstatements.

However, as highlighted previously we have a number of potentially significant queries that need to be resolved. If they were all to be resolved to our satisfaction, we would anticipate issuing an unqualified audit opinion. However, at this stage it is not yet clear that this will be complete when the Statement of Accounts is due to be approved by the Audit, Pensions, and Standards Committee on 13 September 2016. We will update the Committee orally at the meeting.

In addition, 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 governance statement

We have reviewed the Annual Governance Statement and confirmed that:

- It complies with *Delivering Good Governance in Local Government: A Framework* published by CIPFA/SOLACE; and
- It is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

We have made a number of comments in respect of its format and content which the Authority has agreed to amend where significant.

Narrative report

We have reviewed the Authority's narrative report and can confirm it is not inconsistent with the financial information contained in the audited financial statements.

Pension fund annual report

The Pension Fund Annual Report has been prepared and we are in the process of confirming that the financial and non-financial information it contains is consistent with the financial information contained in the audited financial statements.

We anticipate issuing an opinion on the Pension Fund Annual Report at the same time as our opinion on the Statement of Accounts.

The statutory deadline for publishing the document is 1 December 2016. The Pension Fund Annual Report is currently due to be approved by the Audit, Pensions and Standards Committee on 13 September 2016.

Significant audit risks



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

Valuation of Property, Plant and Equipment - No issues were noted as a result of the testwork performed.

Managed Services Implementation - We have noted issues in the processing of transactions by BT and in the way debtor and creditor balances are matched at year end. See Appendix one for further detail.

In our *External Audit Plan 2015/16*, presented to you in June 2016, we identified the significant risks affecting the Authority's 2015/16 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

The table below sets out our detailed findings for each of the risks that are specific to the Authority.

Valuation of Property, Plant and Equipment

- Risk: As at 31 March 2016 the value of the Council's PPE was £1.8 billion. Local authorities exercise judgement in determining the fair value of different classes of assets held and the methods used to ensure the carrying values recorded each year reflect those fair values. The Council is responsible for ensuring that the valuation of PPE is appropriate at each financial year end and for conducting impairment reviews that confirm the condition of these assets. We assessed that the inherent uncertainty in valuation and high value of assets held by the Council creates a significant risk to the financial statements for 2015/16.
- Findings: As part of our 2015/16 audit, we have reviewed management's assessment of property valuations and impairment calculations; confirmed the information provided to the valuer from the Authority; compared the assumptions made by your valuer to benchmarks and to the assumptions used for 2014/15 for consistency; completed testing over new capital additions in year to confirm appropriately capitalised and that Council ownership is evidenced; and reviewed disposals made in year and confirmed appropriate removal from the PPE balance in 2015/16. No issues were noted as a result of the testwork performed.

Managed Services Implementation

- Risk: The Tri-borough councils implemented a new financial system on 1 April 2015 through a managed service partnership with BT. There have been a number of difficulties with the implementation which gives rise to a significant risk over the completeness and accuracy of the balances in the financial statements.
- Findings: As part of our 2015/16 audit, we have performed testing over the opening balances imported into the Agresso system, reviewed the testing carried out by the finance team to gain assurance over the accuracy of transactions being made by BT; reviewed the Internal Audit work completed related to the implementation; and carried out substantive testing over material balances in the financial statements. As a result of the implementation of managed services we have modified our audit approach from a controls based to a substantive risk based audit. We have performed additional tests of detail over significant balances, specifically in Debtors, Creditors, Income and Expenditure. During our testing, we have noted issues in the processing of journal transactions by BT and in the way debtor and creditor balances are matched at year end. See Appendix one for further detail.

Significant audit risks



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

Fraud risk of revenue recognition - 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.

Management override of controls - There are no matters arising from this work that we need to bring to your attention.

In our *External Audit Plan 2015/16* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. These risk areas were Management override of controls and the Fraud risk of revenue recognition.

The table below sets out the outcome of our audit procedures and assessment on these risk areas.

Fraud risk of 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 2015/16* 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.

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.

Other areas of focus



In our External Audit Plan 2015/16, presented to you in June 2016, we identified nine areas of audit focus. These are not considered as significant risks but areas of importance where we would carry out some substantive audit procedures to ensure there is no risk of material misstatement.

We have now completed our testing. The table sets out our detailed findings for each of the areas of audit focus.

No issues were noted as a result of these procedures.

Housing Benefits Expenditure - £148m in 15/16 (£187m in 14/15)

Audit Focus: Housing benefits is area of audit focus due to the size of the figures and the degree of complexity inherent in the calculation of benefit payable.

Findings: We have gained an understanding over controls related to housing benefits expenditure; completed substantive analytical review of rent rebates and rent allowances; and reconciled expenditure to the subsidy claim form. We note that we will be performing a full audit of the subsidy grants claim form prior to the relevant deadline at the end of November 2016.

No issues were noted as a result of these procedures.

Business rates income (NDR) - £60m in 15/16 (£50m in 14/15)

Audit Focus: NDR is material, has complexity in the translation from Collection Fund into Council prime statements and a degree of judgment underlying the NDR appeals provision.

Findings: We have gained an understanding over controls related to business rates income; tested the operating effectiveness of five Valuation Office Agency (VOA) to Academy reconciliations; completed substantive analytical review of income; and agreed precepts to underlying documentation. We have also considered the basis of the appeals provision and noted that it appears reasonable.

No issues were noted as a result of these procedures.

Council tax income - £53m in 15/16 (£53m in 14/15)

Audit Focus: Council tax is a material income stream for the Authority and there is complexity surrounding the translation from Collection Fund into Council primary statements.

Findings: We have gained an understanding over controls related to Council tax income; tested the operating effectiveness of five VOA to Academy reconciliations; completed substantive analytical review of income; and agreed precepts to underlying documentation.

No issues were noted as a result of these procedures.



HRA Rental Income - £70m in 15/16 (£67m in 14/15)

Audit Focus: HRA dwelling rental income is an area of audit focus due to the material size.

Findings: We have gained an understanding over controls related to HRA rental income; tested the operating effectiveness of controls over the annual approval of rents by the Cabinet; completed substantive analytical review of dwelling rent income and reconciled the HRA amounts to the Authority's CIES.

No issues were noted as a result of these procedures.

HRA Repairs and Maintenance and Management Expenditure - £33m in 15/16 (£43m in 14/15)

Audit Focus: HRA expenditure over repairs & maintenance and supervision & management is an area of audit focus due to the material size.

Findings: We have gained an understanding over controls related to HRA expenditures and completed substantive analytical review of HRA expenditures. We have tested the operating effectiveness of controls over 25 starters, 25 leavers, and the authorisation of 25 non-pay expenditures and performed substantive testwork over payroll and non-payroll expenditure, which included expenditure related to HRA.

No issues were noted as a result of these procedures.

Accounting for pension assets and liabilities - £491m in 15/16 (£522m in 14/15)

Audit Focus: Pension valuations require a significant level of expertise, judgement and estimation and are therefore more susceptible to error. This is also a very complex accounting area increasing the risk of misstatement.

Findings: We have confirmed the information provided to the actuary from the Authority; reviewed the actuarial valuation and considered the disclosure implications; and considered the assumptions made by your actuaries to benchmarks, which are collated by our KPMG actuaries and to the assumptions used for 2014/15 for consistency.

No issues were noted as a result of these procedures.



Payroll - £178m in 15/16 (£181m in 14/15)

Audit Focus: Payroll represents a significant proportion of the Authority's annual expenditure. Whilst not considered overly complex from a material error perspective, we consider that it is important from an audit perspective to understand the nature of the Authority's expenditure in this area. This is also an area impacted by Managed Services.

Findings: We have reviewed the effectiveness of controls over 25 starters and 25 leavers; completed substantive analytical review of payroll costs; and tested supporting system information used to compile the review. We have gained an understanding of control reconciliations performed by BT during the year under audit, but have not relied on these controls for the purposes of our audit.

No issues were noted as a result of these procedures.

Non-Payroll Expenditure - £533m in 15/16 (£548m in 14/15)

Audit Focus: Non-payroll expenditure, specifically the accounts payable component, is an area of audit focus due to its pervasive impact on the financial statements and size. This is also an area impacted by Managed Services.

Findings: We have tested the operating effectiveness of controls over the authorisation of 25 non-payroll expenditures. We have performed substantive tests of details to agree 93 expenditures to third party documentation and cut-off testing of 25 non-payroll expenditure to ensure costs are recorded in the correct period. No issues were noted as a result of these procedures.

No issues were noted as a result of these procedures.

Cash - £101m in 15/16 (£59m in 14/15)

Audit Focus: Cash has a pervasive impact on the financial statements and provides comfort for other areas of the financial statements. This is also an area impacted by Managed Services.

Findings: We have reviewed the year end bank reconciliation and confirmed balances with external third parties. No issues were noted as a result of these procedures. We have gained an understanding of control reconciliations performed by BT during the year under audit, but have not relied on these controls for the purposes of our audit.

No issues were noted as a result of these procedures.

Significant audit risks – pension fund



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

This section sets out our detailed findings on those risks.

In our External Audit Plan 2015/16, presented to you in March 2016, we did not identify any significant risks affecting the Authority's Pension Fund's 2015/16 financial statements. However, during the course of the audit we have identified the change in service provider as a significant risk.

The table below sets out our detailed findings for each of the risks that are specific to the Pension Fund.

Managed Services Implementation & Change in Service Provider

- Risk: The Tri-borough councils implemented a new financial system on 1 April 2015 through a managed service partnership with BT. There have been a number of difficulties with the implementation. This affects the Pension Fund through the administration of payroll data. In addition the pension administration services have transferred from Capita to Surrey County Council in September 2015.
- Findings: As part of our 2015/16 audit, we have performed testing over the listings of active members and pensioners as part of our testing to gain assurance over contributions and benefits. We have found inaccuracies in the data provided due to Surrey County Council not receiving information from BT and inheriting incorrect/incomplete data from the previous administrator (Capita). We are currently working with the relevant teams to obtain complete and accurate listings of members, which will then enable us to complete our work.

Significant audit risks – pension fund



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

Fraud risk of revenue recognition - We do not consider this to be a significant risk for Pension Funds as there is unlikely to be an incentive to fraudulently recognise revenue.

Management override of controls - There are no matters arising from this work that we need to bring to your attention.

In our *External Audit Plan 2015/16* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. These risk areas were Management override of controls and the Fraud risk of revenue recognition.

The table below sets out the outcome of our audit procedures and assessment on these risk areas for the Fund.

Fraud risk of 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 2015/16 we reported that we do not consider this to be a significant risk for Pension Funds 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.

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 of the Fund.

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.

Other areas of focus – pension fund



In our External Audit Plan 2015/16, presented to you in June 2016, we identified one area of audit focus relating to the Pension Fund.

Work on this area is ongoing.

Pension Fund Investments - £856m in 15/16 (£866m in 14/15)

Audit Focus: The value of pension fund investment assets is a material item in your financial statements, which can involve an element of judgment and uncertainty.

Findings: We reviewed the valuation of the Pension Fund investments, including the unlisted investments, and consider the independent assurance that is available in respect of the valuation processes and valuations of funds. However we have not yet received all the required assurance to conclude on the valuation of level 2 and level 3 investments held by the Fund (total value in the financial statements is £174m for level 2 investments and £71m for level 3 investments). We have reviewed the disclosure notes in the light of relevant requirements.



We always consider the level of prudence within key judgements in your financial statements. We have summarised our view below using the following range of judgement:



Assessment of subjective areas			
Asset/liability class	15/16	Balance (£m)	KPMG comment
Accruals	3	£47 million <i>(PY: £30 million)</i>	<p>We have agreed a sample of the accruals recorded in your financial statements to supporting documentation, including confirmation of post-year end payment. We have reviewed a sample of post-year end payments to check the cut-off of expenditure recorded in the period and ensured there are no unrecorded liabilities at the year end.</p> <p>Based on the above work, we believe the Council's assessment to represent a balanced view of future payables and well within the acceptable range of estimates</p>
Grants	3	£82 million <i>(PY: £107 million)</i>	<p>We noted that grants income is split into £62m of non-ring fenced government grants and £19m capital grants and contributions. For non-ring fenced grants, we selected items with high value or large fluctuations from prior year and agreed these back to supporting documentation, including grant receipts to bank statements. For capital grants, we agreed a sample of grants back to supporting documentation and confirmed that conditions have been met to release income. We have performed additional procedures over the Dedicated Schools Grant income, agreeing the budget and award to notification and sample of expenditure items to remittance advice.</p> <p>Based on the above work, we believe the Council's assessment to represent a balanced view of grant income recognised in the period.</p>
Business rate appeals	3	£60 million <i>(PY: £50 million)</i>	<p>We tested and agreed underlying data used to calculate the NDR provisions. The data used to calculate the appeals provision came from a Valuation Office Agency (VOA) report. All appeals go via the VOA. We assessed the reasonableness of the Council's approach and that the figures could be reconciled to VOA reports. We noted that in the Chancellor of the Exchequer's Autumn Statement 2014, the backdating of NDR appeals would no longer be allowed after 1/4/15. After this statement, the Council noted a large increase in the amount of appeals lodged as rating agents were trying to ensure that their interests were covered. Because of the speculative nature of these appeals, the Council has recognised a provision at 50% of the potential value of the appeal, instead of the full 100% before 1/1/15.</p> <p>The judgements used appeared reasonable throughout our testing and well within the acceptable range of estimates.</p>



Assessment of subjective areas			
Asset/liability class	15/16	Balance (£m)	KPMG comment
Property, Plant and Equipment (valuations / asset lives)	3	£1,807 million (PY: £1,667 million)	<p>We have reviewed management’s assessment of property valuations and impairment calculations; confirmed the information provided to the valuer from the Authority; and compared the assumptions made by your valuer to benchmarks and to the assumptions used for 2014/15 for consistency.</p> <p>Overall we have concluded the Trust has made a balanced estimate and that the judgements represent a balanced assessment of asset usage.</p>
Pensions	3	£491 million (PY: £522 million)	<p>We have reviewed the actuarial valuation for pensions and considered the assumptions made by your actuaries in comparison to benchmarks, which are collated by our KPMG actuaries, and to the assumptions used for 2014/15 for consistency.</p> <p>Our view is that the Council and its actuaries are balanced in determining the net pension liability and well within the acceptable range of estimates.</p>
Other accounting policies	3	N/A	<p>We have reviewed the Authority’s accounting policies as contained in the accounts to ensure consistency with the relevant accounting standards and the CIPFA Code. We have also analysed any changes in accounting policy from the previous period.</p> <p>We have determined that the Authority’s accounting policies are consistent with those set out in the CIPFA code, prior year accounting policies, and our understanding of the Authority’s application of them.</p>
Reserves	3	£113 million (PY: £104 million)	<p>We have reviewed the Earmarked Reserves disclosure for reasonableness and agreed all significant movements between reserves to confirm they are appropriate and have been authorised by the relevant individual. We believe the Council’s judgement to be balanced.</p>

Accounts production and audit process



We have noted the continued high quality of the accounts and the supporting working papers.

Officers dealt efficiently with audit queries and the audit process could be completed within the planned timescales.

Initial testing of the Pension Fund identified that member and pensioner listings were not complete or accurate due to difficulties with the inherited data from Capita and current data received from BT. Additional work is being undertaken.

The Authority has not implemented two of the recommendations in our *ISA 260 Report 2014/15*. We have re-raised these recommendations in the current year. Appendix one provides further details.

Accounts production and audit process

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

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	<p>The Authority has experienced challenges in its financial reporting process as a result of managed services implementation; however, these issues have been addressed throughout 2015/16 and mitigated through additional officer action where possible. There is scope to improve this further by improving the focus of communication between BT and local teams, particularly in the processing of transactions and mapping of accounts. Additional controls assurance should be sought from BT through the request of a third-party control assurance report (ISAE 3402) or specific internal audit work. This would provide insight into the strength of controls at the service organisation and therefore additional assurance to officers and members.</p> <p>We consider that accounting practices are appropriate.</p>
Completeness of draft accounts	<p>We received a complete set of draft accounts on 24 June 2016. The Authority made a small number of amendments of a presentational nature after this date but prior to the start of the audit.</p>

Element	Commentary
Quality of supporting working papers	<p>Our <i>Accounts Audit Protocol</i>, which we issued on 6 June 2016 and discussed with the Head of Finance, set out our working paper requirements for the audit.</p> <p>The quality of working papers provided met the standards specified in our <i>Accounts Audit Protocol</i>.</p>
Response to audit queries	<p>Officers resolved the majority of audit queries in a reasonable time. In some cases, however, we experienced delays, specifically where working papers needed to be requested from third parties. As part of our audit debrief, we will engage with all concerned to understand how best to communicate our audit requests in future.</p>
Pension Fund Audit	<p>The audit of the Fund was completed alongside the main audit. Initial testing identified that member and pensioner listings were not complete or accurate due to significant difficulties with the inherited data from Capita and current data received from BT. We are working with the Authority to resolve these issues but are likely to need to extend our testing or start again using revised information.</p>

Findings in respect of the control environment for key financial systems

We have completed our testing of controls operated during the closedown process and noted some issues with journal entry transactions processed at BT. Appendix one provides further details.

As part of our audit we have specifically followed up the Authority's progress in addressing the recommendations in last years ISA 260 report. The Authority has not implemented two of the recommendations in our *ISA 260 Report 2014/15*. Appendix one provides further details.



We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.

Before we can issue our opinion we require a signed management representation letter.

Once we have finalised our opinions and conclusions we will prepare our Annual Audit Letter and close our audit.

Declaration of independence and objectivity

As part of the finalisation process we are required to provide you with representations concerning our independence.

In relation to the audit of the financial statements of LBHF Council and LBHF Pension Fund for the year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and LBHF Council and LBHF 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 four 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 Strategic Finance Director for presentation to the Audit, Pensions, and Standards 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.



Section four: Value for Money

VFM Conclusion



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

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.

Background

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

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

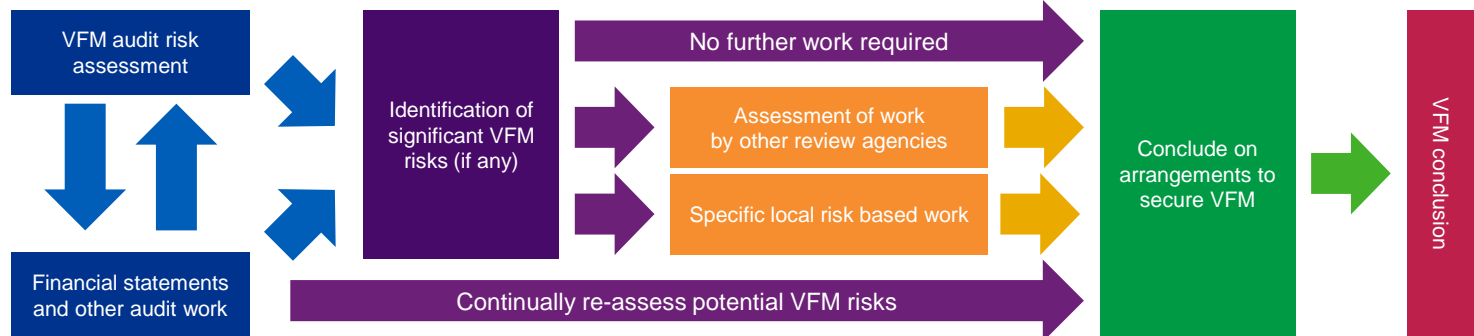
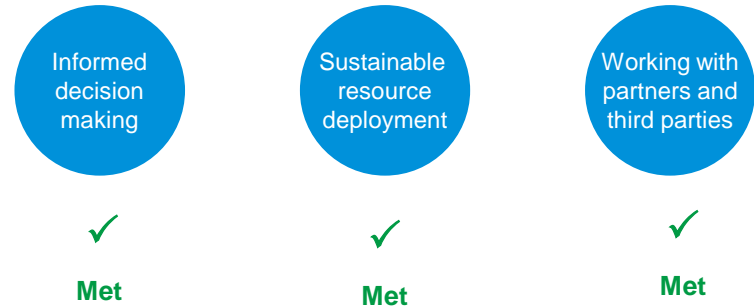
The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria.

These sub-criteria provide a focus to our VFM work at the Authority.

Conclusion

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.

Overall criterion
In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.



Specific VFM Areas of Focus



We have not identified any specific VFM risks. However, we have identified three areas of audit focus related to VFM.

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

We concluded that we needed to carry out additional work for some of these areas. This work is now complete and no issues were identified.

Work completed

In line with the risk-based approach set out on the previous page, and in our *External Audit Plan* we have:

- Assessed the Authority's key business risks which are relevant to our VFM conclusion;
- Identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;
- Considered the results of relevant work by the Authority, inspectorates and review agencies in relation to these risk areas; and
- Completed specific local risk based work on three areas of audit focus

Key findings

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

We concluded that we needed to carry out additional work for some of these areas. This work is now complete and we also report on this below.

Key VFM area of focus	Risk description and link to VFM conclusion	Assessment
	<p>Procurement and Contract Management. We will consider the process for managing contracts entered into by the Trust to ensure that performance objectives are being achieved and any issues are being managed.</p> <p>This is relevant to the working with partners and third parties sub-criteria of the VFM conclusion.</p>	<p>A new Contract Management Framework which is designed to improve contract management and provide a consistent approach across the council is being rolled out across departments. The Council's internal audit have undergone a number of reviews related to contract management.</p> <p>Audit focus based work required: Yes</p> <p>Through our review of the internal audit reviews related to contract management, our testing of a sample of two contracts, and our discussions with the Head of Internal Audit and the Commercial Director, we have determined that there are proper arrangements in place to ensure that LBHF has achieved value for money in its workings with partners and third parties.</p>

Specific VFM Areas of Focus (cont.)



<p>We have not identified any specific VFM risks. However, we have identified three areas of audit focus related to VFM.</p> <p>In all cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these areas are adequate.</p> <p>We concluded that we needed to carry out additional work for some of these areas. This work is now complete and no issues were identified.</p>	Key VFM area of focus	Risk description and link to VFM conclusion	Assessment
	<p>Managed Services →</p>	<p>The Tri-borough councils implemented a new managed service partnership with BT on 1 April 2015. There have been a number of difficulties with the implementation which gives rise to a risk over management's ability to make informed decision making and has an impact on forward planning and budget monitoring.</p> <p>This is relevant to the informed decision making, sustainable resource deployment, and working with partners and third parties sub-criteria of the VFM conclusion.</p>	<p>The Council have put action plans in place to ensure that there are appropriate mitigating controls for weaknesses in the Managed Services arrangement. There are regular meetings with the Managed Services Provider through Operational Framework Board (OFB) and Managed Services Sponsors meeting to track progress against targets. A comprehensive and regularly reviewed risks and issues register is being maintained.</p> <p>Audit focus based work required: Yes</p> <p>Through our review of the Managed Services contract and related documentation, analysis of the OFB minutes, and meetings with the Head of Finance and Head of Managed Services, we have determined that there are proper arrangements in place to ensure LBHF took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people in relation to managed services.</p>
<p>MTFS →</p>	<p>Sustainable resource deployment – determining the financial resilience of LBHF over the longer term. We will consider how they are monitoring and delivering on their savings plans to ensure sustainability.</p> <p>This is relevant to the sustainable resource deployment sub-criteria of the VFM conclusion.</p>	<p>The council manages its financial risks through a range of controls including budget preparation, budget setting and a framework which sets out the roles and responsibilities for managing, monitoring and forecasting income and expenditure against approved budgets. Regular in-year monitoring, review of future financial plans and assessment of financial risks and reserves are undertaken to ensure the financial plans are delivered.</p> <p>Audit focus based work required: Yes</p> <p>Through our review of the budget monitoring controls and Medium Term Financial Strategy and our testing of ten cost improvement schemes, we have determined that there are proper arrangements in place to ensure that resources are deployed to achieve planned and sustainable outcomes for taxpayers and local people.</p>	



Appendices

Appendix 1: Key issues and recommendations

Appendix 2: Audit differences

Appendix 3: Independence and objectivity

Key issues and recommendations

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

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

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.	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.
		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.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
1	1	<p>Transactions processed by service organisation</p> <p>During our testwork over journal transactions, we were unable to view supporting evidence or verify segregation of duties for transactions initiated at BT.</p> <p>During other areas of our testwork, including debtors and pensions, we noted several instances of transactions that were originally posted incorrectly by BT and detected/corrected by local finance staff.</p> <p>Typically, service organisations provide an assurance report on controls at the service organisation (ISAE 3402). The report would be issued by a third party and provide an assessment of the financial control environment. This was not provided (or commissioned) by BT.</p> <p>Recommendation</p> <p>The Council should consider how to obtain assurance over the control environment at BT. This can be achieved through the commissioning of an ISAE 3402 as noted above or specific internal audit work undertaken at BT. The resulting report should be reviewed by management and any areas for local consideration should be actioned accordingly.</p>	<p>We will investigate and consider options as to how we can obtain increased assurance over the control environment at BT. This may include an internal review of controls, an externally certified review, or a combination of both. Management will review any findings and ensure that any areas for local consideration are actioned accordingly.</p> <p>Strategic Finance Director March 2017</p>

Key issues and recommendations (cont.)

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
2	2	<p>Cross-Entity Journal Entries</p> <p>During our testwork over journals transactions, we identified four cross-entity journals which were inappropriately posted by local finance staff who should not have had the ability to do so. These journals resulted from the use of the pre-approved journal template, which was designed and brought into use as a work around due to technical issues with the Agresso system. BT and the Council have mitigating controls in place to detect out of balance entries, including the daily trial balance download. In all instances, the transactions above were detected and corrected. However, the Council is currently lacking a control to prevent these entries from occurring.</p> <p>Recommendation</p> <p>BT and LBHF should work to resolve technical issues with Agresso and reduce the number of spreadsheet journals processed in order to prevent the posting of cross-entity journals.</p>	<p>LBHF will work with BT to minimise the risk of posting cross-entity journals and enhance preventative controls. We will continue to operate robust detective controls in this area.</p> <p>Strategic Finance Director December 2016</p>
3	2	<p>Matching of debtors and creditors</p> <p>During our current Debtor and current Creditor testing, we noted several instances where debtors and creditors had not been netted off against each other properly. In two instances, these amounts were significant and required audit adjustment (See appendix two).</p> <p>Recommendation</p> <p>We recommend that the Council undergo a remapping exercise to ensure that the TB mapping to debtors and creditors is accurate (i.e. that debtor contra accounts are not mistakenly mapped to creditors and vice versa). In addition, the finance team should consider performing an analysis of debtors and creditors at year end to identify specific items or areas that would be appropriate to net against each other.</p>	<p>LBHF will review the mapping of debtors and creditors and will also review the use of the chart of accounts. Corporate Finance will undertake more detailed analysis of debtors and creditors at year end to identify specific items or areas that would be appropriate to net against each other.</p> <p>Strategic Finance Director December 2016</p>

Follow up of prior year recommendations

The Authority has not implemented all of the recommendations in our *ISA 260 Report 2014/15*.

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

This appendix summarises the progress made to implement the recommendations identified in our ISA 260 Report 2014/15 and re-iterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	2
Implemented in year or superseded	0
Remain outstanding (re-iterated below)	2

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at Aug 2016
1	2	<p>Non-Current Asset Management (<i>Carried over from 2012-13</i>)</p> <p>The Authority has over 14,000 assets with a value of approximately £1.8bn which are controlled and utilised by departments and divisions across the Council. An asset base of this scale and diversity poses a number of challenges, both from a technical perspective with differences in valuation treatments and in terms of maintaining up to date records. The Authority currently uses a number of spreadsheets as its asset database and to perform the required accounting calculations. This relies on a number of manual calculations and is both time consuming throughout the year and places significant time pressures of the Capital team during the year end closedown process.</p> <p>The Authority should consider implementing an asset management system with the required functionality to improve efficiency of officers throughout the year and increase accuracy in the financial reporting process reducing the risk of error.</p>	<p>Persons Responsible: Director for Finance</p> <p>Date for Completion: To be kept under review, see next column</p>	<p>Open</p> <p>The council's new finance system Agresso does have a Fixed Asset module. However, given other priorities it has been decided not to implement this module at this stage.</p> <p>With the work done on the manual spreadsheets over the last few years, they have become more automated, with built in checks and controls, and they provide accurate and clear data to produce the accounts and demonstrate good practice for the audit. There were no material errors in the accounts in the Non-Current Assets area.</p> <p>The Council is keeping the position under review and once issues in other areas are fully resolved, and management are confident a new fixed asset system can be successfully implemented a new system will be implemented.</p>

Follow up of prior year recommendations (cont.)

The Authority has not implemented all of the recommendations in our *ISA 260 Report 2014/15*. We re-iterate the importance of the outstanding recommendations and recommend that these are implemented as a matter of urgency.

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at Aug 2016
2	3	<p>Preparation of Politically Sensitive Disclosures</p> <p>During our 2014/15 work on Members Allowances, Senior Officer Remuneration, and Exit Packages, we noted several misstatements in this key disclosure.</p> <p>Recommendation</p> <p>We recommend that the Council implement a more stringent review over the preparation of politically sensitive disclosures and increase communication between the Finance and HR teams to ensure that information presented in these notes is accurate.</p>	<p>Persons Responsible: Director for Finance</p> <p>Date for Completion: March 2016</p>	<p>Open</p> <p>We noted that the Finance team implemented several actions in 2015/16 to improve the preparation of politically sensitive disclosures.</p> <p>We noted no errors in the Senior Officer Remuneration or Members Allowances disclosures during our testwork.</p> <p>However, whilst not the same error, during our testing of the Exit Packages disclosure, we identified two individuals who were duplicates in the 2014/15 and 2015/16 note, a settlement agreement included in the redundancies, and a number of redundancies which should actually have been classified as 2014/15. In total this caused the 2015/16 Exit Packages disclosure to be overstated by £194k. This error was agreed with officers and the disclosure was amended.</p> <p>We note that this a disclosure error and did not result in any incorrect payments.</p>

Audit differences

This appendix sets out the audit differences.

The financial statements have been amended for all of the errors identified through the audit process.

There is no net impact on the General Fund and HRA as a result of the amendments.

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which in your case is the Audit Committee). We are also required to report all material misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities.

Uncorrected audit differences

We are pleased to report that there are no uncorrected factual audit differences.

Corrected audit differences

Material misstatements

Debtors/Creditors: During our Current Debtor and Current Creditor testing, we noted several instances where debtors and creditors had not been netted off against each other properly. In two instances, these amounts were significant and required audit adjustment. A third immaterial amount was also identified and adjusted.

- Current Creditors dr. £3,514,254.06
- Current Debtors cr. £3,514,254.06

As a result of the adjustments identified above, we requested that management perform additional analysis over debtor/creditor streams to determine if the mapping was accurate and reflected the nature of the balance. As a result of this analysis and our substantive review, additional adjustments were identified and adjusted..

- Current Debtors dr. £1,338,313.58
- Current Creditors cr. £1,338,313.58

Exit Packages: During our testing of the Exit Packages disclosure, we identified two individuals who were duplicates in the 2014/15 and 2015/16 note, a settlement agreement included in the redundancies, and a number of redundancies which should actually have been classified as 2014/15. In total this caused the 2015/16 Exit Packages disclosure to be overstated by £194,449. (Note: politically sensitive disclosures are audited to £1).

Presentational improvements

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

Materiality and reporting of audit differences

For 2015/16 our materiality is £12 million for the Authority's accounts. For the Pension Fund it is £17 million.

We have reported all audit differences over £600,000 for the Authority's accounts and £850,000 for the Pension Fund, to the Audit, Pension, and Standards Committee.

Materiality

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

- Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.
- Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.
- Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We used the same planning materiality reported in our External Audit Plan 2015/16, presented to you in June 2016.

Materiality for the Authority's accounts was set at £12 million which equates to around 1.7% percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit, Pension, and Standards 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, Pension, and Standards Committee any misstatements of lesser amounts to the extent that these are identified by our audit work.

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

ISA 450 requires us to request that uncorrected misstatements are corrected.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £600,000 for the Authority.

Where management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit, Pension, and Standards 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 £17 million which is approximately 2% percent of net investment assets.

We design our procedures to detect errors at a lower level of precision, set at £11.5 million for 2015/16.

Declaration of independence and objectivity

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice.

Requirements

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice (the 'Code') which states that:

"The auditor should carry out their work with integrity, objectivity and independence, and in accordance with the ethical framework applicable to auditors, including the ethical standards for auditors set by the Financial Reporting Council, and any additional requirements set out by the auditor's recognised supervisory body, or any other body charged with oversight of the auditor's independence. The auditor should be, and should be seen to be, impartial and independent. Accordingly, the auditor should not carry out any other work for an audited body if that work would impair their independence in carrying out any of their statutory duties, or might reasonably be perceived as doing so."

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Public Sector Audit Appointments Ltd *Terms of Appointment* ('Public Sector Audit Appointments Ltd Guidance') and the requirements of APB Ethical Standard 1 *Integrity, Objectivity and Independence* ('Ethical Standards').

The Code states that, in carrying out their audit of the financial statements, auditors should comply with auditing standards currently in force, and as may be amended from time to time. Public Sector Audit Appointments Ltd guidance requires appointed auditors to follow the provisions of ISA (UK&I) 260 Communication of *Audit Matters with Those Charged with Governance* that are applicable to the audit of listed companies. This means that the appointed auditor must disclose in writing:

- Details of all relationships between the auditor and the client, its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the client, its directors and senior management and its affiliates, that the auditor considers may reasonably be thought to bear on the auditor's objectivity and independence.
- The related safeguards that are in place.
- The total amount of fees that the auditor and the auditor's network firms have charged to the client and its affiliates for the provision of services during the reporting period, analysed into appropriate categories, for example, statutory audit services, further audit services, tax advisory services and other non-audit services. For each category, the amounts of any future services which have been contracted or where a written proposal has been submitted are separately disclosed. We do this in our *Annual Audit Letter*.

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from his. These matters should be discussed with the Audit, Pension, and Standards Committee.

Ethical Standards require us to communicate to those charged with governance in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on our independence and the objectivity of the Engagement Lead and the audit team.

Declaration of independence and objectivity (cont.)

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.

General procedures to safeguard independence and objectivity

KPMG's reputation is built, in great part, upon the conduct of our professionals and their ability to deliver objective and independent advice and opinions. That integrity and objectivity underpins the work that KPMG performs and is important to the regulatory environments in which we operate. All partners and staff have an obligation to maintain the relevant level of required independence and to identify and evaluate circumstances and relationships that may impair that independence.

Acting as an auditor places specific obligations on the firm, partners and staff in order to demonstrate the firm's required independence. KPMG's policies and procedures regarding independence matters are detailed in the *Ethics and Independence Manual* ('the Manual'). The Manual sets out the overriding principles and summarises the policies and regulations which all partners and staff must adhere to in the area of professional conduct and in dealings with clients and others.

KPMG is committed to ensuring that all partners and staff are aware of these principles. To facilitate this, a hard copy of the Manual is provided to everyone annually. The Manual is divided into two parts. Part 1 sets out KPMG's ethics and independence policies which partners and staff must observe both in relation to their personal dealings and in relation to the professional services they provide. Part 2 of the Manual summarises the key risk management policies which partners and staff are required to follow when providing such services.

All partners and staff must understand the personal responsibilities they have towards complying with the policies outlined in the Manual and follow them at all times. To acknowledge understanding of and adherence to the policies set out in the Manual, all partners and staff are required to submit an annual ethics and independence confirmation. Failure to follow these policies can result in disciplinary action.

Auditor declaration

In relation to the audit of the financial statements of the London Borough of Hammersmith and Fulham Council and the London Borough of Hammersmith and Fulham Pension Fund for the financial year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and the London Borough of Hammersmith and Fulham Council and the London Borough of Hammersmith and Fulham 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.

Audit Fees

Our scale fee for the audit was £163,950 plus VAT (£216,000 in 2014/15) for the accounts audit and £21,000 plus VAT (£21,000 in 2014/15) for the Pension Fund. This fee was in line with that highlighted within our audit plan agreed by the Audit Committee in June 2016. Our scale fee for certification for of grant claims for Housing Benefits, Teachers Pension and Pooling Capital Receipts was £23,756 plus VAT, (£31,720 in 2014/15).

Non-audit services

With the exception of the grant certification work noted above, we have not been engaged to provide any non-audit services in the year.



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The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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