# External Audit Report 2017/18

**Royal Borough of Kensington and Chelsea**

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July 2018

# Content

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This report is addressed to the Royal Borough of Kensington and Chelsea (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. PSAA 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 PSAA'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, you should contact Andrew Sayers (0207 694 8981, andrew.sayers@kpmg.co.uk), 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 (PSAA). 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.

# Important notice

This report is presented in accordance with our PSAA engagement. Circulation of this report is restricted. The content of this report is based solely on the procedures necessary for our audit. This report is addressed to the Royal Borough of Kensington and Chelsea (the Authority) and has been prepared for your use only. We accept no responsibility towards any member of staff acting on their own, or to any third parties. The National Audit Office (NAO) has issued a document entitled Code of Audit Practice (the Code). This summarises where the responsibilities of auditors begin and end and what is expected from the Authority. External auditors do not act as a substitute for the Authority'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.

**Basis of preparation:** We have prepared this External Audit Report (Report) in accordance with our responsibilities under the National Audit Office Code of Audit Practice (the Code) and the terms of our Public Sector Audit Appointments Ltd (PSAA) engagement.

**Purpose of this report:** This Report is made to the Authority's Audit and Transparency Committee in order to communicate matters as required by International Audit Standards (ISAs) (UK and Ireland) and other matters coming to our attention during our audit work that we consider might be of interest and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone (beyond that which we may have as auditors) for this Report or for the opinions we have formed in respect of this Report.

**Limitations on work performed:** This Report is separate from our audit opinion and does not provide an additional opinion on the Authority's financial statements nor does it add to or extend or alter our duties and responsibilities as auditors. We have not designed or performed procedures outside those required of us as auditors for the purpose of identifying or communicating any of the matters covered by this Report. The matters reported are based on the knowledge gained as a result of being your auditors. We have not verified the accuracy or completeness of any such information other than in connection with and to the extent required for the purposes of our audit.

**Status of our audit:** Our audit is not yet complete and matters communicated in this Report may change pending signature of our audit report. We will provide an oral update on the status of our audit at the Audit and Transparency Committee meeting. The following work is ongoing:

- **Financial statements audit and pension fund:** Review of contract management process for 2 contracts, additions asset testing in relation to the properties acquired for social housing purposes within the General Fund, senior officers remuneration, remuneration bandings, exit costs, journals and pension fund and financial statement finalisation procedures.
- **Whole of Government accounts pack:** Work ongoing.
- **Value for Money:** Work still to be completed – see page 4.

In addition we have to complete our final review procedures and post balance sheet events review.

# Summary

## Financial statements audit – see section 2 for further details

Subject to all outstanding queries and procedures being satisfactorily resolved we intend to issue an unqualified audit opinion on the Authority's financial statements for the deadline of 31 July 2018, following the Audit and Transparency Committee adopting them and receipt of the management representations letter. We would highlight, however that we understand information to support the properties acquired for social housing purposes within the General Fund is taking longer than expected to compile and this could delay our sign-off.

We also anticipate issuing an unqualified audit opinion in relation to the Pension Fund's financial statements at the same time that we issue our opinion on the Authority's financial statements.

We have read the Narrative Report and reviewed the Annual Governance Statement (AGS). Our key findings to date are:

- There are no unadjusted audit differences.
- We agreed presentational changes to the accounts with Finance, mainly related to compliance with the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.
- We are requesting the routine management requests which are consistent with those requested in previous years.
- We will report that your AGS complies with delivering Good Governance guidance issued by CIPFA / SOLACE in April 2016.
- We did not receive any queries or objections from local electors this year. We have one query pending from 2016/17.

We cannot issue our Annual Audit Letter until our Value for Money Responsibilities are complete. We cannot issue our audit certificate closing the audit until the Value for Money Responsibilities are complete and we have completed our work on the pending objection.

## Value for money – see section 3 for further details

Our VFM audit approach requires us to consider findings from other inspectorates and review bodies. Following the Grenfell Tower fire a number of investigations and enquiries have commenced. As reported to you in 2016/17, as a result of this we have identified areas of further work we need to undertake and consider before we can issue our VFM conclusion for both 2016/17 and 2017/18. The matters we need to consider are potentially included in the inspections already in progress by central government and other regulatory bodies. We await the outcome of these inspections where upon we will consider the findings of the inspections and enquiries before deciding where we can use the findings of the inspection work and where we may need to undertake work ourselves. Therefore, at the date of this report we have delayed issuing both our 2016/17 and 2017/18 VFM conclusions until we have completed our work.

# Summary

## 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.).

We have a duty to consider whether to issue a report in the public interest about something we believe the Authority should consider, or if the public should know about.

We have not identified any matters that would require us to issue a public interest report. In addition, we have not had to exercise any other audit powers under the Local Audit & Accountability Act 2014

There are no other matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority's 2017/18 financial statements.

We identified [#] prior year recommendations that require further action by Management. We have made 1 new recommendation as a result of our 2017/18 work. The recommendation relates to the maintenance of complete asset records. All recommendations are shown in appendix 1.

We undertake other grants and claims work for the Authority that does not fall under the PSAA arrangements. The status of our grants and claim work is summarised below:

- Teachers Pensions: The reporting accountant assurance deadline is the 30 November 2018. We will complete the fieldwork in relation to this in October 2018;
- Pooling of Housing Receipts: The reporting accountant assurance deadline is the 30 November 2018. We will complete the fieldwork in relation to this in October 2018;
- Education and Skills Funding Agency Subcontractor Grant Claim: The reporting accountant assurance deadline is the 14 September 2018. We will complete the fieldwork in relation to this in August and September 2018; and
- Housing Benefits: The reporting accountant assurance deadline is the 30 November 2018. We will complete the fieldwork in relation to this in August and September 2018.

The fees for this work is explained in section two.

# Financial statements audit

We audit your financial statements by undertaking the following:

| | Accounts production stage | | |
|---|---|---|---|
| **Work Performed** | **Before** | **During** | **After** |
| **1. Business understanding:** review your operations | ✓ | ✓ | – |
| **2. Controls:** assess the control framework | ✓ | – | – |
| **3. Prepared by Client Request (PBC):** issue our prepared by client request | ✓ | – | – |
| **4. Accounting standards:** agree the impact of any new accounting standards | ✓ | ✓ | – |
| **5. Accounts production:** review the accounts production process | ✓ | ✓ | ✓ |
| **6. Testing:** test and confirm material or significant balances and disclosures | – | ✓ | ✓ |
| **7. Representations and opinions:** seek and provide representations before issuing our opinions | ✓ | ✓ | ✓ |

We have completed the first six stages and report our key findings below:

| | |
|---|---|
| 1. Business understanding | In our 2017/18 audit plan we assessed your operations to identify significant issues that might have a financial statements consequence. We confirmed this risk assessment as part of our audit work. We provide an update on each of the risks identified later in this section. |
| 2. Assessment of the control environment | We assessed the effectiveness of your key financial system controls that prevent and detect material fraud and error. We found that the financial controls on which we seek to place reliance are operating effectively. We reviewed work undertaken by your internal auditors, in accordance with ISA 610 and used the findings to inform our work. We have chosen not to place reliance on their work due to the approach we adopted for the financial statements audit. |
| 3. Prepared by client request (PBC) | We produced the PBC to summarise the working papers and evidence we ask you to collate as part of the preparation of the financial statements. We discussed and tailored our request with the Chief Accountant and this was issued as a final document to the finance team. We are pleased to report that this has resulted in generally good-quality working papers maintained on the KPMG sharepoint database. Minor areas for refinement were noted and discussed with the finance team. As noted earlier information to support properties acquired for social housing purposes within the General Fund is taking longer than expected to compile. |

# Financial statements audit

| | |
|---|---|
| 4. Accounts Production | We received complete draft accounts on 31 May 2018, ahead of the publication deadline. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.<br><br>The Authority incorporated measures into its closedown plan to manage this complex process. The Authority recognised the additional pressures which the earlier closedown brought and we engaged with officers in the period leading up to year end to proactively address issues as they emerged. We consider that the overall process for the preparation of your financial statements is adequate. We would highlight that as the timetable for the accounts production tightens, increased scrutiny and documentation around areas requiring estimate and any change at the year end, should be documented.<br><br>We thank Finance for their cooperation throughout the audit. |
| 5. Testing | We have summarised the findings from our testing of significant risks and areas of judgement in the financial statements on the following pages. During the audit we identified only presentational issues which have been adjusted, none had a material impact on the financial statements. |
| 6. Representations | 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 Executive Director of Resources and Assets on 13 July 2018. We draw attention to the requirement in our representation letter for you to confirm to us that you have disclosed all relevant related parties to us. |

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, opening balances, public interest reporting, questions/objections, etc.).

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority’s 2017/18 financial statements.

To ensure that we provide a comprehensive summary of our work, we have over the next pages set out:

- The results of the procedures we performed over the valuation of land and buildings, the valuation of the pension liability, managed services operation and faster close which were identified as significant risks within our audit plan and which will form a part of our audit opinion;
- The results of our procedures to review the required risks of the fraudulent risk of revenue recognition and management override of control; and
- Our view of the level of prudence applied to key balances in the financial statements.

# Financial statements audit

## Authority significant audit risks

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

| SIGNIFICANT audit risk | Account balances effected | Summary of findings |
|---|---|---|
| **Valuation of land and buildings**<br><br>The Authority held land and buildings with a net book value of £1,565 million at 31 March 2018. 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 land and buildings revalued over a five year cycle unless it is thought that the value may have changed materially where they are revalued more frequently. As a result 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.<br><br>In 2017/18 the Authority has significant property additions to the general fund, £145M of which is held as assets under construction at the year end. | **Note 15: PPE**<br><br>£1,565 million<br><br>PY £1,404 million (NBV) | 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 mitigated risk by undertaking a full 100% revaluation with the exception of five investment properties not re-valued in 2017/18<br><br>We have:<br><br>• reviewed the approach that the Authority adopted to assess the risk that assets not subject to valuation were materially misstated and considered the robustness of that approach;<br><br>• reviewed management's assessment of property valuations and impairment calculations;<br><br>• confirmed the information provided to the valuer (JLL) from the Authority;<br><br>• compared the assumptions made by your valuer to benchmarks and to the assumptions used for 2016/17 for consistency;<br><br>• completed testing over new capital additions in year to confirm these are appropriately capitalised in accordance with guidance and valuations and that Authority ownership is evidenced; and<br><br>• reviewed disposals made in year and confirm appropriate removal from the PPE balance in 2017/18.<br><br>The Council has received a direction from the Secretary of State which permits it to hold up to 250 properties acquired for social housing purposes within its General Fund.<br><br>**Our work is ongoing in this area, in particular in relation to the properties acquired for social housing purposes within the General Fund where the information on properties acquired is taking longer than expected to compile.**<br><br>**We noted that the Fixed Asset Register (FAR) is not being updated on a regular basis. Aligned to this, as part of the monthly bank reconciliation process, asset purchases should be reconciled. We have raised a recommendation in this area within Appendix 1.** |

# Financial statements audit

| SIGNIFICANT audit risk | Account balances effected | Summary of findings |
|---|---|---|
| **Pension: Valuation of assets and liabilities**<br><br>The net pension liability at 31 March 2018 of £249 million represents a material element of the Authority's balance sheet. The Authority is a scheduled body of the Royal Borough of Kensington and Chelsea 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. Valuation of the Local Government Pension Scheme relies on assumptions, most notably actuarial assumptions, and actuarial methodology which results in the Authority's overall valuation. | **Note 18: Long Term Liabilities**<br><br>**Note 37: Defined benefit pension scheme**<br><br>Long Term Liabilities of £249 million relates to the Pension Fund Liability.<br><br>PY: Long Term Liabilities of £281 million relates to the Pension Fund Liability. | 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.<br><br>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.<br><br>There is a risk that the assumptions and methodology used in the valuation of the Authority's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements.<br><br>As part of our work we reviewed the controls that the Authority has in place over the information sent to the Scheme Actuary, including the Authority's process and controls with respect to the assumptions used in the valuation. We also evaluated the competency, objectivity and independence of the external actuary.<br><br>We reviewed the appropriateness of the key assumptions included within the valuation and compared them to expected ranges. We involved a KPMG Actuary to provide a specialist assessment of those assumptions. We also reviewed the methodology applied in the valuation by the external actuary.<br><br>In addition, we reviewed the overall Actuarial valuation and considered the disclosure implications in the financial statements.<br><br>In order to determine whether the net pension liability has been appropriately accounted for we also considered the valuation of pension assets. As part of our audit of the Pension Fund we gained assurance over the overall value of fund assets. We then liaised with the actuary to understand how these assets are allocated across participating bodies and reperformed this allocation.<br><br>**Whilst work is ongoing in this area, there are no issues that we need to bring to your attention.** |

# Financial statements audit

| SIGNIFICANT audit risk | Account balances effected | Summary of findings |
|---|---|---|
| **Managed Services**<br><br>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 since 1 April 2015, which, whilst progress has been made, have not yet been fully resolved. This continues to give rise to a risk in relation to the completeness and accuracy of the balances in the financial statements.<br><br>Since 2015 there have been difficulties in implementation and day to day processing that represent a risk to the completeness and accuracy of the balances within the financial statements. Whilst we note that work has been done to rectify many issues and progress has been made, a risk remains in relation to the outsourced services. | n/a | We have reviewed the processes and controls linked to BT managed services including bank reconciliations, journal controls (including cross entity journals), payroll and pensions controls, debtors and creditors reconciliations, income and debt management, non pay expenditure controls together with general IT controls for super users, disaster recovery and back up.<br><br>On a sample basis, we tested the design and implementation of the controls surrounding the key financial systems, including payroll, debtors, creditors and cash. We also tested the operation of key IT controls, for example system password access controls together with those controls surrounding the set up/removal of users to the system.<br><br>We documented and tested the General IT Controls (GITC) in place which support the safe storage and access to/from financial records.<br><br>**We did not identify significant areas of weakness following our work which would impact on the material accuracy of the financial statements.** |
| **Faster Close**<br><br>In prior years, the Authority has been required to prepare draft financial statements by 30 June and then final signed accounts by 30 September. For years ending on and after 31 March 2018 revised deadlines apply which require draft financial statements by 31 May and final signed financial statements by 31 July. | n/a | We have liaised with officers in preparation for our audit to understand the steps the Authority had taken to meet the revised deadlines. We undertook additional early testing at our interim audit around those areas of higher volume testing to help streamline the year end audit work. |

# Financial statements audit

## Authority other areas of audit focus

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

| Other areas of audit focus | Account balances effected | Summary of findings |
|---|---|---|
| **Note 23: NNDR appeals provision** | £11 million<br><br>PY £7.2 million | The Authority use an independent body to calculate the appeals provision. We have:<br>• gained an understanding over controls related to business rates income and specifically the appeals process;<br>• reviewed the methodology applied in determining the appeal provision including whether this reflects a balanced, cautious or optimistic assessment; and<br>• ensured the report is complete by agreeing data back the Valuation Office Agency (VOA) data.<br>**There are no issues that we need to bring to your attention.** |
| **Note 33: (Conditional) Grant income** | £238 million<br><br>PY £255 million | We have:<br>• reviewed the controls in place to ensure that grants are recognised only when there is reasonable assurance that the Authority will comply with any conditions attached to the grant;<br>• ensured for a sample of grants, that they have been applied over the period necessary to match them with the related costs, for which they are intended to compensate, on a systematic basis; and<br>• ensured that the accounting policy adopted for grants, including method of balance sheet presentation, nature and extent of grants recognised in the financial statements and any unfulfilled conditions and contingencies attached to recognised grants has been disclosed within the accounts.<br>**There are no issues that we need to bring to your attention.** |
| **Note 7: Employee benefit expenses** | £187 million<br><br>PY £169 million | We have:<br>• tested reconciliations for gross pay and deductions (e.g. pensions, tax and national insurance); and<br>• Substantively tested the payroll balance using statistical sampling. We statistically tested basis pay, agency pay, schools payroll and key deductions.<br>**There are no issues that we need to bring to your attention.** |

# Financial statements audit

| Other areas of audit focus | Account balances effected | Summary of findings |
|---|---|---|
| **Note 21: Cash & cash equivalents** | £103 million<br>PY £9 million | We have:<br>• reviewed the year end bank reconciliation;<br>• confirmed cash balances with external third parties; and<br>• reviewed, on a sample basis, school cash balances held by the Authority.<br>**There are no issues that we need to bring to your attention.** |
| **Note 7: Non-Payroll Expenditure**<br><br>**Note 22: Short term creditors** | £620 million<br>PY £501 million<br><br>£145 million<br>PY £103 million | We have:<br>• agreed a statistical sample of non pay expenditure to third party documentation to confirm classification per the Code;<br>• undertaken cut-off testing, whereby we test a sample of transactions in the period between the 31 March 2018 and the ledger close to ensure these are recorded in the correct period; and<br>• statistically selected a sample of short term creditors and confirmed classification to source documentation.<br>Grenfell related spend has been recorded in both the General Fund and HRA in accordance with the statutory accounting requirements. As at 31 March, the gross costs were £86.5M. This has been funded from a combination of the Section 31 grant received from Government and the remaining costs, c£51.2M is funded from Council resources.<br>**Work is ongoing in this area. We have raised an adjustment is this areas as noted within Appendix 3.** |
| **HRA: HRA Rental Income and Repairs and Maintenance and Management Expenditure** | R&M<br>£16 million<br>PY £12 million<br>S&M<br>£18 million<br>PY £15 million | We have:<br>• gained an understanding over controls related to HRA expenditure;<br>• completed substantive analytical review of expenditures. We have also linked our work to that over payroll and non-payroll expenditure;<br>• Considered the consolidation of Repairs Direct and the treatment within the financial statements (Note 34)<br>The Council have recorded Grenfell related expenditure in both the HRA and the General Fund. To avoid an adverse impact on the Council's tenants and leaseholders, the Council has obtained an Item 9 Credit Direction from the Secretary of State which permits it to transfer £6.4m from the General Fund to the HRA.<br>**We have reviewed this and raised a presentational adjustment. This Is detailed in Appendix 3.** |

# Financial statements audit

## Pension Fund significant audit risks

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

| SIGNIFICANT audit risk | Account balances effected | Summary of findings |
|---|---|---|
| **Pension Fund Net Asset Statement**<br>Valuation of hard to price investments | Net Assets:£1,082 million<br>PY: Net Assets: £1,051 million | The Pension Fund invests in a wide range of assets and investment funds, some of which are inherently harder to value or do not have publicly available quoted prices, requiring professional judgement or assumptions to be made at year end. The pricing of complex investment assets may also be susceptible to pricing variances given the number of assumptions underlying the valuation.<br>In the prior year financial statements, £56 million out of a total of £1,019 million of investments, or 5.5%, were in this harder to price category. For year ended 31 March 2018, £53 million out of a total of £1,074 million of investments, or 4.9%, were in this harder to price category.<br>As part of our audit of the Pension Fund, we independently verified a selection of investment asset prices to third party information and obtained independent confirmation on asset existence. We also tested the extent to which the Pension Fund had challenged the valuations reported by investment managers for harder to price investments and obtained independent assessment of the figures.<br>**There are no issues that we need to bring to your attention.** |

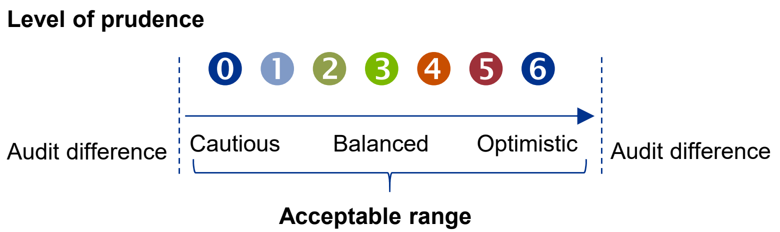
# Financial statements audit

| Risks that ISAs require us to assess in all cases | Why | Our findings from the audit |
|---|---|---|
| Fraud risk from revenue recognition<br><br>**Authority & Pension Fund** | Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.<br><br>We do not consider this to be a significant risk for the majority of the Authority's and Pension Fund income as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk for council tax, business rates, housing rents, annual central government grants, social services income and pension fund contributions and do not incorporate specific work into our audit plan in these areas over and above our standard fraud procedures. However, we do consider it for income relating to s106 monies that span financial years and often have to be used on specific projects. | For other income, we obtained a breakdown of Cost of Services and removed Grant income credited to services. We removed the conditional grant element and tested this as below:<br><br>• We classified conditional grant income as an area of audit focus for 2017/18 and have outlined above the audit work we undertook which also fulfilled our responsibilities for this objective. Other income was tested as an other account within our audit work.<br><br>• Other areas of income, for example taxation and precepts were tested for completeness.<br><br>**There are no matters arising from this work that we need to bring to your attention.** |
| Fraud risk from management override of controls<br><br>**Authority & Pension Fund** | 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.<br><br>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.<br><br>We have not identified any specific additional risks of management override relating to this audit. | Our procedures, including testing of journal entries, accounting estimates and significant transactions outside the normal course of business, no instances of fraud were identified.<br><br>We have performed specific procedures to:<br><br>• review accounting judgements which are impacting the reported outturn position;<br><br>• review of controls associated with, and undertaken, sample testing of manual journals;<br><br>• reconciled the year end performance to in year financial report to ensure that divergence in performance can be understood and justified; and<br><br>• reviewed the year end cut off process to ensure that revenue and expenditure items have been reflected within the correct period.<br><br>**We would note that cross-entity journals do still occur and there have been two instances during the year. However, management and BT have developed a more robust process of addressing them. These instances were identified and remedied prior to audit.** |

# Financial statements audit

### Judgements in your financial statements

We consider the level of prudence in key judgements in your financial statements.  We summarise our view below using the following scale:




| Assessment of subjective areas | | | | |
|---|---|---|---|---|
| **Asset / liability class** | **Current year** | **Prior year** | **Balance (£m)** | **KPMG comment** |
| Note 23: NNDR provisions | 1 | 3 | £7M<br>PY £11M | In 2013/14, local authority funding arrangements meant that the Authority is now responsible for a proportion of successful rateable value appeals.  The Authority use an external specialist 'LG futures' to inform their NNDR appeals provision.  The Authority provides for a fixed percentage of outstanding appeals in accounting for the potential liability, based on historical appeals success rates.  The Authority have considered the LG futures data, but have included a provision greater than the experts analysis.  This is not a material difference.<br>**Based on the above work, we believe the Authority has represented a cautious view of NNDR provisions, within the acceptable range of estimates.** |
| Note 15: PPE Valuation | 2 | 3 | £1,565M<br>PY £1,403M | The Authority continues its use of the beacon methodology in line with the DCLG's *Stock Valuation for Resource Accounting* published in November 2016.  The Authority has utilised their external valuation expert to provide valuation estimates.  Our KPMG valuation specialist had discussed the valuation process with the Authority specialist and reviewed the valuation approach. We deem that the valuation exercise is in line with the instructions.   **Overall we have concluded the Authority has made a balanced estimate and that the judgements represent a valid assessment of asset usage.**<br>Other land and buildings have been subject to a revaluation in the year. This has led to an increase in the valuations. We have used our KPMG valuation specialist to review the assumptions.<br>**Work on note 15 specifically around PPE AUC additions, is ongoing.** |

# Financial statements audit

| Assessment of subjective areas | | | | |
|---|---|---|---|---|
| **Asset / liability class** | **Current year** | **Prior year** | **Balance (£m)** | **KPMG comment** |
| Note 15: PPE: asset lives | 3 | 3 | N/A | 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 2016/17 for consistency.<br><br>**Overall we have concluded the Authority has made a balanced estimate and that the judgements represent a valid assessment of asset usage.** |
| Note 37: Pension liability | 3 | 3 | £249M<br><br>PY £281M | The Authority continues to use Barnett Waddingham to provide actuarial valuations in relation to the assets and liabilities recognised as a result of participation in the Local Government Pension Scheme. Due to the overall value of the pension assets and liabilities, small movements in the assumptions can have a significant impact on the overall valuation.<br><br>The actual assumptions adopted by the actuary fell within our expected ranges as set our below:<br><br>• 3 Discount Rate: 2.55%, past service liability 20 years<br>• 2 Pension Increase Rate: 2.3%<br>• 3 Inflation: 1% PA below RPI, i.e 2.3%<br>• 3 Salaries assumed to increase at 1.5% above CPI<br><br>**The overall set of assumptions proposed by the employer can be considered to be balanced relative to our central rates for a typical UK scheme.** |
| Note 38: Accounting policies | 3 | 3 | n/a | We have reviewed the Authority's accounting policies contained in the financial statements 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.<br><br>We have determined that the Authority's accounting policies are consistent with those set out in the CIPFA Code, with prior year accounting policies, and are consistent with our understanding of the Authority's application of them. |

# Financial statements audit

| Assessment of subjective areas | | | | |
|---|---|---|---|---|
| **Asset / liability class** | **Current year** | **Prior year** | **Balance (£m)** | **KPMG comment** |
| Note 10: Earmarked Reserves | ❸ | ❸ | £125M<br>PY £127M | The Authority have undertaken a streamlining of Earmarked reserves, implementing fewer, larger reserves. 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.<br>**We believe the Authority's judgement to be balanced.** |

# Financial statements audit

### Narrative report and Annual Governance Statement of the Authority

We have reviewed the Authority's narrative report and Annual Governance Statement and have confirmed that it is consistent with the financial statements, guidance and our understanding of the Authority.

### Pension fund audit

The audit of the pension fund and the Pension Fund Annual Report was completed alongside the main audit.  There are no specific matters to bring to your attention relating to this.

### Pension fund annual report

We reviewed the consistency of the Fund's financial statements in the Fund's Annual Report and the financial statements included in the Royal Borough of Kensington and Chelsea's financial statements.  We confirm that the Fund's financial statements are consistent with the pension fund financial statements included in the accounts of the Royal Borough of Kensington and Chelsea.  We read the information in the Fund's Annual Report to identify material inconsistencies with the Fund's financial statements. We can confirm it is not inconsistent with the financial information contained in the audited financial statements.  As such we anticipate issuing an unqualified consistency opinion on the pension fund financial statements.

### Queries from local electors

We did not receive any questions or objections from members of the public this year, but have one outstanding query from 2016/17.

# Financial statements audit

### Financial Statements Audit opinion

Subject to the receipt of all outstanding information and testing therein, we anticipate completing all our responsibilities in relation to the audit of the accounts for the year end 31 March 2018 and anticipate issuing our audit opinion.

We cannot issues our certificate until our work on VFM and local elector queries from prior years are resolved.

### Whole of Government Accounts (WGA)

We received your WGA consolidation pack and work is ongoing in relation to this. We anticipate issuing an unqualified consistency report.

### Other grants and claims work

We undertake other grants and claims work for the Authority that does not fall under the PSAA arrangements.  The status of our grants and claim work is presented below:

- Teachers Pensions: The reporting accountant assurance deadline is the 30 November 2018.  We will complete the fieldwork in relation to this in October 2018; and
- Pooling of Housing Receipts: The reporting accountant assurance deadline is the 30 November 2018.  We will complete the fieldwork in relation to this in October 2018;
- Education and Skills Funding Agency Subcontractor Grant Claim: The reporting accountant assurance deadline is the 14 September 2018.  We will complete the fieldwork in relation to this in August 2018;. and
- Our work on the certification of Housing Benefits (BEN01) is planned for August 2018.  The planned scale fee for this is £26,170 excluding VAT (£ 19,905 excluding VAT in 2016/17).

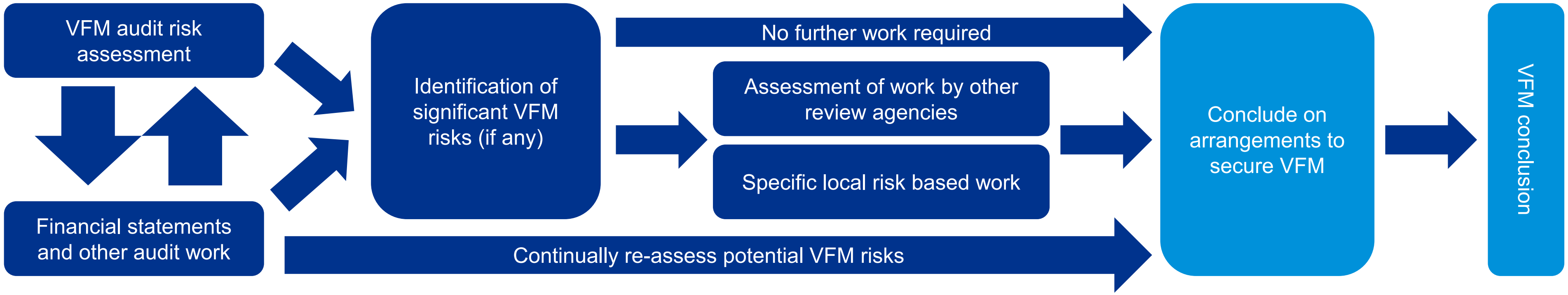
Planned fees for other grants and claims which do not fall under the PSAA arrangements is £11,250 excluding VAT (£11,250 excluding VAT in 2016/17).

# Value for money

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

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

We follow a risk based approach to target audit effort on the areas of greatest audit risk as summarised below:




We identified two significant VFM risks within our plan. Commentary on these areas is provided overleaf.

As reported to you in our 2016/17 ISA, our VFM audit approach requires us to consider findings from other inspectorates and review bodies. Following the Grenfell Tower fire a number of investigations and enquiries have commenced. As reported to you in 2016/17, as a result of this we have identified areas of further work we need to undertake and consider before we can issue our VFM conclusion for both 2016/17 and 2017/18. The matters we need to consider are potentially included in the inspections already in progress by central government and other regulatory bodies. We await the outcome of these inspections where upon we will consider the findings of the inspections and enquiries before deciding where we can use the findings of the inspection work and where we may need to undertake work ourselves. Therefore, at the date of this report we have delayed issuing both our 2016/17 and 2017/18 VFM conclusions until we have completed our work.

# Value for money

## VFM audit work

As reported within our Audit Plan, we identified two significant risks. Our findings in relation to these are outlined below.

| VFM sig risk | Why this risk is significant | Our audit response and findings |
|---|---|---|
| Medium Term Financial Planning (MTFP) | **Risk:** Reductions in central government funding, additional costs arising following Grenfell, combined with other pressures have increased financial pressures within the Authority. The Authority continues to strive to identify and deliver savings whilst delivering a challenging capital delivery program. We will consider the ongoing impact of these costs pressures and changing capital profile on the financial reliance of the Authority. We will also consider how the Authority identifies, approves, and monitors savings plans and how budgets more widely have been managed and monitored throughout the year. | We have reviewed the controls the Authority has in place to ensure financial resilience, including how the Authority identifies, approves, and monitors savings plans and how budgets are managed throughout the year.<br><br>We have also reviewed the Medium Term Financial Plan (MTFP) to ensure that it has taken into consideration factors such as funding reductions, salary and general inflation, demand pressures, restructuring costs and sensitivity analysis given the degree of variability in the above factors.<br><br>The 2017/18 budget was approved in March 2017 and updated again in November 2017. In year financial management included monthly monitoring of expenditure and income against budget and quarterly reporting to Members through both the Leadership Team and Scrutiny Committees.<br><br>The initial outturn report detailed an underspend of £4.6m after agreed carry forwards for future use by services and proposed use of reserves. This excludes the unbudgeted net expenditure on Grenfell recovery of £51.2m which has been funded from council resources.<br><br>Financial pressures have been most severe in children's services where an overspend of almost £5m was reported.<br><br>Working balances have been kept at £10m, which is consistent with prior years.<br><br>The Capital Programme outturn position was expenditure of £225.3M against a budget of £268.44M. The remaining £51.6M will be carried forward to 2018/19 to fund the completion of the schemes.<br><br>In November 2017, the Council undertook a detailed review of reserves. The objective of this was to streamline the number of reserves, strengthen the financial control over the use of reserves and to part fund costs arising from the Grenfell fire. As part of this review, two new reserves were created – the Special Projects Reserve and the Grenfell Reserve.<br><br>The 2018/19 budget is more challenging. The balanced budget was approved in February 2018 and included only the second council tax increase in 8 years together with c£12M of required savings. The budget also included £36.8M in relation to Grenfell spend. Further one-off reserve releases are included in the budget to support Grenfell related expenditure.<br><br>The revised HRA business plan indicates that at a minimum, current average annual stock investment is around £22m. Significantly more than has been included in recent capital budgets. The spend needed over the next 5 years is likely to be in the region of c£180M, subject to an updated stock condition survey. |

# Value for money

| VFM sig risk | Why this risk is significant | Our audit response and findings |
|---|---|---|
| MTFP continued | | As part of the autumn budget, Government announced £28m towards the costs of supporting survivors of Grenfell, including a £15m grant for the refurbishment of the Lancaster West Estate. These funds are due to be received in 2018/19. The Council has committed to matching this funding for Lancaster West.<br><br>Based on the 18/19 budget, the HRA surplus is forecast to vary from £7.7M in March 18, to £19.3M in 2023. However, these budgets remain in a volatile position. |
| KCTMO | **Risk:** The Board of Kensington and Chelsea Tenant Management Organisation (KCTMO) has agreed to temporarily hand back management of the housing stock to the Authority. This means the Authority will again be responsible for repairs, looking after the estates and running the day to day services. KCTMO will remain as a separate legal entity. We will consider the controls surrounding the management of counterparty risk following the temporary service transfer – including, how data protection requirements have been applied following any contractual movements and consideration of the management of financial risks; and for contracts more widely, we will consider the process for managing contracts entered into by the Authority to ensure that performance objectives are being achieved and any delivery issues are being managed in accordance with agreed governance requirements. | The Council is the landlord of 6,729 social tenanted homes and 2,593 leasehold properties. As the landlord, the Authority has legal obligations in respect of the management of these properties, the performance of which was delegated to the KCTMO under the Modular Management Agreement (MMA).<br><br>At its meeting on 10 January 2018, the Leadership Team considered the KCTMO decision to hand back the estate services, as provided under the under the terms of the MMA. A transfer date of 1 March was agreed and the KCTMO transferred on that date. However, KCTMO continues to exist as a legal entity and will do for at least the duration of the Public Enquiry.<br><br>At March 2018, the Authority became the sole shareholder to Kensington and Chelsea TMO Repairs Direct Limited (known as Repairs Direct) for £1.The Director of Housing Management has delegated responsibility to manage the service.<br><br>The Council has agreed funding with KCTMO for 2018/19 and will provide adequate funding as required in future years to ensure that the KCTMO can be represented at any enquiry.<br><br>The costs of taking back the direct management of housing stock will be borne by the HRA. The HRA business plan reflects this. However, a new stock condition survey has been commissioned which will give a more accurate picture of the level of investment required. During the transition, project teams were established covering HR, Finance, Operations, ICT Communications and Repairs Direct workstreams. This was managed through a Transitions Board who in turn reported to a Strategic Board. The Board was chaired by the Executive Director of Resources and Assets.<br><br>Key risks have been identified and mitigating actions have been developed. Aligned to this, a revised HRA business plan and budget has since been developed to ensure delivery against revised priorities. The Housing and Property Scrutiny Committee has acted as key challenge tool, with further oversight from the leadership committee. |

## Appendix 1

# Recommendations raised and followed up

Recommendations raised as a result of our work in the current year are as follows:

| Priority rating for recommendations | | | | | |
|---|---|---|---|---|---|
| ❶ | 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. | ❷ | 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. | ❸ | 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. |

| # | Risk | Recommendation | Management Response / Officer / Due Date |
|---|---|---|---|
| **Financial statements** | | | |
| 1 | ❶ | **Completeness of asset records**<br>The Fixed Asset Register (FAR) helps an organisation understand and report on the lifecycle of assets.<br>The FAR should be updated accurately and in a timely manner for acquisitions, transfers, sales and disposals. To facilitate this, all acquisitions should be supported by proof of ownerships and an accurate valuation.<br>The fixed asset register should be updated on a regular basis to reflect the changing asset base. Aligned to this, as part of the regular bank reconciliation, asset purchases and disposals should be reconciled.<br>Robust asset management will support the effective management and tracking of the asset lifecycle. Failure to maintain such records can lead to inaccurate and incomplete financial reporting and a weak audit trail. | **Agreed**<br>Following the fire at Grenfell Tower, the Council has been under extreme pressure to support and re-house survivors. The property purchase programme to support this has been intense during the year and the priority has been focussed around securing sufficient suitable properties and in a timely manner. The Council secured support from external solicitors to secure the sales and manage the legal process. In line with the process in previous years, the Council's FAR is updated as part of the year end process. However, officers agree the recommendation and will put in place processes to update the FAR bi-annually.<br>Responsible officer: Taryn Eves, Acting Director of Financial Management, 31 March 2019 |

# Recommendations raised and followed up

Recommendations raised as a result of our work in the previous year are as follows:

| 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. |

| Total number of recommendations | Number of recommendations implemented | Number outstanding |
|---|---|---|
| 2 | 1 | 1 |

| # | Risk | Recommendation | Management Response / Officer / Due Date |
|---|---|---|---|
| **Financial statements** | | | |
| 1 | 2 | **Approval of Exit Payments**<br>We were unable to obtain evidence of approval for the exit payments of one individual. This individual received an exit payment of £100k. Whilst there was a settlement agreement in place, signed by the Authority's in-house legal counsel, we were unable to obtain evidence of Council or senior management approval for the payment.<br>**Recommendation:** The Authority should ensure all exit payments above £50k are approved by management in line with the Constitution and Scheme of Delegation. Evidence of the appropriate authorisation should be maintained. | **Updated management response (July 2018)**<br>**Implemented**<br>The Council's processes have been reviewed to ensure that all cases are appropriately reported. All cases above £100k are now reported to the Admin Committee.<br>**Original management response**<br>**Agreed**<br>The current authorisation process will be reviewed to ensure authorisations are stored in and can be evidenced from a single source.<br>Responsible officer: Director for HR<br>Due date: 31 January 2018 |

# Recommendations raised and followed up

| # | Risk | Recommendation | Management Response / Officer / Due Date |
|---|---|---|---|
| **Financial statements** | | | |
| 2 | ❸ | **IT Control Deficiencies – Leavers and User Access**<br><br>During our audit of the IT environment at BT Managed Services, we identified a large number of leavers who had not been approved from the IT system promptly after the leaving date. Similarly, the majority of new users, who are not on temporary contracts, to the system are entered with an expiry date of 2099, rather than a fixed end date, meaning many user access rights will continue indefinitely.<br><br>Whilst further testing identified that none of these individuals accessed the ledger inappropriately after their leaving date, there is a risk to the Authority that leavers can inappropriately access the ledger after they have left the Authority. The lack of end date means that there is no fixed process whereby BT is encouraged to monitor user access regularly.<br><br>**Recommendation:** The importance of removing leavers from the IT system should be reaffirmed to BT Managed Services and a routine check is developed to identify any leavers who might still inappropriately have access to Agresso. New users should be given an expiry date after 12 months so that user access does not continue indefinitely where this is not appropriate. | **Updated management response (July 2018)**<br><br>**Partly Implemented**<br><br>It is the responsibility of individual managers to ensure that their staffing establishment are up to date. This includes both at month end budget monitoring and as part of their self-serve role as a manager. All managers are responsible for notifying BT of any starters and leavers and are encouraged to use the contract end date for those on fixed term contracts and interim arrangements<br><br>**Original management response**<br><br>**Agreed**<br><br>The use of the 2099 end date is an Agresso default for any open ended employment. The end date would only vary for a notified leave/end date and this should be updated for all leavers in a timely manner. There are some operational reasons why the end date isn't updated promptly. We will seek to provide some clarity on some of the exceptions where this is the case.<br><br>Responsible officer: Head of Framework ICF for Managed Services/ Chief Accountant<br><br>Due date: 31 March 2018 |

# Recommendations raised and followed up

We have followed up the recommendations from the 2015/16 audit, in summary:

| Total number of recommendations | Number of recommendations implemented | Number outstanding (repeated below): |
|---|---|---|
| 3 | 1 | 2 |

| # | Risk | Recommendation | Management Response / Officer / Due Date |
|---|---|---|---|
| **Financial statements** | | | |
| 1 | ❶ | **Transactions processed by service organisation**<br>During our test work journal transactions, we were unable to verify segregation of duties for transactions initiated at BT relating to error corrections. This was the case for 6 of the journals we tested.<br>During other areas of our testwork, including debtors, we noted several instances of transactions that were originally posted incorrectly by BT and detected/corrected by local finance staff.<br>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.<br>**Recommendation**<br>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. | **Updated management response (July 2018)**<br>**Partly Implemented**<br>Internal Audit have undertaken a series of reviews at BT Managed Services and have raised a number of recommendations to management. In order to gain more assurance also the KPMG audit team has also conducted a visit of the managed service provider to gain an understanding of the control environment at BT. Over the last 12 months, the focus has been on maintaining a good service with BT and although the scope for changes has been limited as a result of the move to Hampshire, good controls have been in place.<br>**Partially Implemented**<br>There is still no segregation of duties of transactions initiated at BT. However, Internal Audit have undertaken a series of reviews at BT Managed Services and have raised a number of recommendations to management. In order to gain more assurance also the KPMG audit team has also conducted a visit of the managed service provider to gain an understanding of the control environment at BT.<br>**Original Management Response**<br>The Council will investigate and consider options as to how it 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. The Council will review any findings and ensure that any areas for local consideration are actioned accordingly.<br>Responsible officer: Kevin Bartle, Executive Director of Resources and Assets<br>Due date: 31 March 2017 |

# Recommendations raised and followed up

| # | Risk | Recommendation | Management Response / Officer / Due Date |
|---|---|---|---|
| **Pension Fund** | | | |
| 2 | ❶ | **Pension Fund membership data**<br>Pension fund data integrity has been impacted by both the transfer of administering responsibilities from Capita to Surrey County Council (SCC), and through the introduction of a new financial ledger through the managed services program.<br>We undertake a number of analytical procedures within the pension fund audit. As part of this, we need to gain assurance over the pension fund membership data through detailed sample testing.<br>During our initial testing of membership data on contributions and pension benefits, we found a number of issues which required us to expand our sample in order to be able to reach an opinion on the financial statements<br>The Council is aware of the issues encountered with the handover of data from Capita to SCC both in terms of technical difficulties and completeness/accuracy of data held; and also the lack of a direct interface between BT managed services systems and SCCs pensions administration systems. Consequently, there is a comprehensive plan to ensure all membership data is complete and accurate within the next 6-12 months.<br>**Recommendation**<br>Once the cleansing of membership data is complete and all parties are agreed that this is the case, RBKC should ensure that a detailed assurance exercise is undertaken. This exercise will need to be more detailed than an audit and could be externally procured or completed by Internal Audit.<br>RBKC should also ensure that it is able to routinely reconcile appropriate information between BT managed services systems and SCCs pensions administration systems. This would provide assurance throughout the year that all contributions are being collected by RBKC and passed to the Pension Fund. | **Updated management response (July 2018)**<br>**Partly Implemented**<br>Data integrity has been an issue following the transfer from Capita to SCC reference the completeness/accuracy of data. The Council will be looking to improve membership data in the run-up to the commencement of the actuarial valuation as at 31 March 2019. The Tri-Borough Investment Team will work closely with Pensions Admin and Surrey County Council to achieve this and this also applies to a detailed assurance exercise post the data cleansing. The reconciliation of data will be between Hampshire County Council and SCCs pensions administration systems post 1 October 2018<br>**Ongoing**<br>The data cleanse process of information inherited from Surrey County Council is still ongoing and is expected to be completed in September 2017.<br>There are still delays in receiving timely information from BT, including a delay in receiving the membership data for the year end accounts which was only recently received. Management at Surrey County Council are continuing to work with BT to develop a live interface between the Altair System used at Surrey and Agresso but the live interface is not yet fully operational.<br>**Original Management response**<br>The Council will ensure that a detailed assurance exercise is put in place to tackle the historical casework backlog inherited from Capita as well as the proposals for cleansing inherited data on the pensions administration system where required. The aim will be to complete the work within a one year period starting on 1 October 2016, although it is recognised that some aspects could take longer if any complicating factors arise.<br>The Council agrees that the reconciliation of pension contributions between BT Managed Services and the Pension Fund needs to be more robust and transparent. The Pensions and Treasury Service is leading on the review of the current processes and will put satisfactory arrangements in place before the end of the current financial year.<br>The Council will commence a reconciliation of appropriate scheme member information between BT Managed Services and Surrey County Council before the end of the current financial year.<br>Responsible officer: Debbie Morris, Bi-Borough Director of HR<br>Due dates: Reconciliation processes will be place by 31 March 2017 with the majority of the casework to be cleared by 30 September 2017 |

## Appendix 2

# Materiality and reporting of audit differences

The assessment of what is material is a matter of professional judgment and includes consideration of three aspects:

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

We used the same planning materiality reported in our External Audit Plan 2017/18.

Materiality for the Authority's accounts was set at £10 million which equates to around 1.8% of gross expenditure.

Materiality for the Pension Fund was set at £16.5 million which equates to around 1.6% of net assets.

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

### Reporting to Audit and Transparency 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 and Transparency 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 £500k for both the Authority and for the Pension Fund.

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 and Transparency Committee to assist it in fulfilling its governance responsibilities.

# Appendix 3

# Audit differences

### Unadjusted audit differences

Under UK auditing standards (ISA (UK&I) 260) we are required to provide the Audit and Transparency Committee with a summary of unadjusted audit differences (including disclosure misstatements) identified during the course of our audit, other than those which are ‘clearly trivial’, which are not reflected in the financial statements. There is one unadjusted differences in relation to the Authority

### Unadjusted difference – Financial Statements

The Authority have included 4 properties within note 17, Investment Properties, where the total value included in the accounts is £651K higher than the valuation.

### Adjusted audit differences

Presentations adjustments were identified.  The most significant of these related to the senior officers remuneration note, exit cost banding, remuneration banding, HRA reclassification of expenditure, non pay expenditure, audit fee, cash flow statement and capital commitments.

**Note 15. PPE AUC additions**.

[To be updated at the Audit Committee].

### Pension Fund

There are no unadjusted or adjusted audit differences identified in relation to the pension fund as at the date of this report.

## Appendix 4

# Audit independence

**ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF THE Royal Borough of Kensington and Chelsea**

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

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

This Statement is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses: general procedures to safeguard independence and objectivity; breaches of applicable ethical standards; independence and objectivity considerations relating to the provision of non-audit services; and independence and objectivity considerations relating to other matters.

**General procedures to safeguard independence and objectivity**

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

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

# Audit independence

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

*Summary of fees*

We have considered the fees charged by us to the authority and its controlled entities for professional services provided by us during the reporting period. Total fees charged by us for the period ended 31 March 2018 can be analysed as follows:

| | **2017-18 £** | **2016-17 £** |
|---|---|---|
| Audit of the Authority | £121,425 | £121,425 |
| Audit of the Pension Fund | 21,000 | 21,000 |
| **Total audit services** | **142,425** | **142,425** |
| Allowable non-audit services | 0 | 7,000 |
| Audit related assurance services | 11,250 | 11,250 |
| Mandatory assurance services (Housing Benefits Grant Claim) | 26,170 | 19,763 |
| **Total Non Audit Services** | **37,420** | **38,013** |

We are required by AGN 01 to limit the proportion of fees charged for non-audit services (excluding mandatory assurance services) to 70% of the total fee for all audit work carried out in respect of the Authority under the Code of Audit Practice for the year. The percentage of non-audit fees to audit fees for the year was 8%.  We do not consider that the total of non-audit fees creates a self-interest threat since the absolute level of fees is not significant to our firm as a whole.

## Appendix 4

# Audit independence

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

| Description of scope of services | Principal threats to independence and Safeguards applied | Basis of fee | Value of services delivered in the year ended 31 March 2018 £ | Value of services committed but not yet delivered £ |
|---|---|---|---|---|
| **Audit-related assurance services** | | | | |
| Grant Certification – Teachers Pensions Return and Pooling of Housing Capital Receipts Return, Education and Skills Funding Agency Subcontractor. | The nature of these audit-related services is to provide independent assurance on each of these returns. As such we do not consider them to create any independence threats. | Fixed Fee | 11,250 | 11,250 |
| **Mandatory assurance services** | | | | |
| Grant Certification – Housing Benefit Subsidy Return | The nature of this mandatory assurance service is to provide independent assurance on each of the returns. As such we do not consider it to create any independence threats. | Fixed Fee | 26,170 | 19,763 |

### Contingent fees

We have not agreed any contingent fees with the Authority.

### Independence and objectivity considerations relating to other matters

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

### Confirmation of audit independence

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

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

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

KPMG LLP

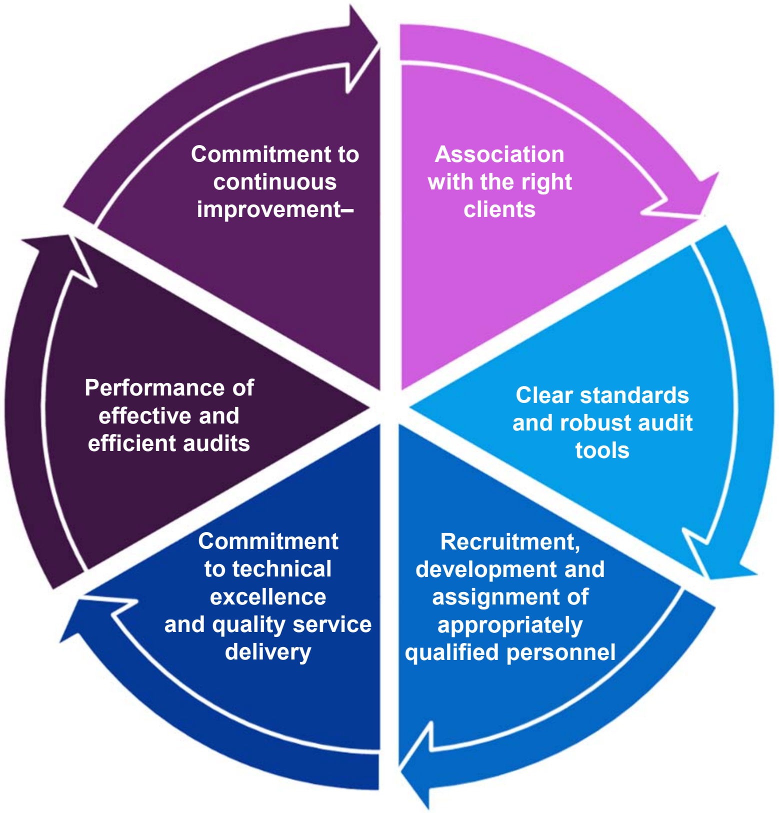
## Appendix 5

# Audit quality framework

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion. To ensure that every partner and employee concentrates on the fundamental skills and behaviours required to deliver an appropriate and independent opinion, we have developed our global Audit Quality Framework

- Comprehensive effective monitoring processes
- Proactive identification of emerging risks and opportunities to improve quality and provide insights
- Obtain feedback from key stakeholders
- Evaluate and appropriately respond to feedback and findings

- Select clients within risk tolerance
- Manage audit responses to risk
- Robust client and engagement acceptance and continuance processes
- Client portfolio management




- Professional judgement and scepticism
- Direction, supervision and review
- Ongoing mentoring and on the job coaching
- Critical assessment of audit evidence
- Appropriately supported and documented conclusions
- Relationships built on mutual respect
- Insightful, open and honest two way communications

- KPMG Audit and Risk Management Manuals
- Audit technology tools, templates and guidance
- Independence policies

- Technical training and support
- Accreditation and licensing
- Access to specialist networks
- Consultation processes
- Business understanding and industry knowledge
- Capacity to deliver valued insights

- Recruitment, promotion, retention
- Development of core competencies, skills and personal qualities
- Recognition and reward for quality work
- Capacity and resource management
- Assignment of team members and specialists

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