Grant Thornton

The Audit Findings for Royal Borough of Kensington and Chelsea and Kensington and Chelsea Pension Fund

Year ended 31 March 2019

September 2019

Contents

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Headlines

This table summarises the key findings and other matters arising from the statutory audits of the Royal Borough of Kensington and Chelsea ('the Council') and Kensington and Chelsea Pension Fund ('the Pension Fund') and the preparation of your financial statements for the year ended 31 March 2019 for those charged with governance.

Financial Statements (Royal Borough of Kensington and Chelsea and Kensington and Chelsea Pension Fund)	Under International Standards of Audit (UK) (ISAs) and the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report whether, in our opinion, your financial statements: • give a true and fair view of the financial position of your circumstances and your income and expenditure for the year; and • have been properly prepared in accordance with the CIPFA/LASAAC code of practice on local authority accounting and prepared in accordance with the Local Audit and Accountability Act 2014. We are also required to report whether other information published together with the audited financial statements (including the Annual Governance Statement (AGS), Narrative Report and Pension Fund Financial Statements), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.	Our audit work commenced on site in June. Our findings are summarised on pages 4 to 20. We have identified two adjustments to the Council's financial statements that have resulted in a net £5.6m adjustment to the Council's Balance Sheet and an £8.3m net adjustment to the Comprehensive Income and Expenditure Statement. These relate to £8.3m additional past service costs relating to the pension fund arising from the McCloud-Sargeant transitional protection ruling, partially offset by £2.7m grant income receivable on the balance sheet which was not recognised in the draft accounts. We have identified no adjustments to the Pension Fund's financial statements that have resulted in an adjustment to the Pension Fund's reported financial position. Audit adjustments are detailed in Appendices B and C. We have also raised recommendations for management as a result of our audit work in Appendix A. Our work is complete and there are no matters of which we are aware at this stage that would require modification of our audit opinions (Appendices E and F) or material changes to the financial statements. It should be noted that this conclusion is subject to the satisfactory resolution of all outstanding matters detailed on page 5. We have concluded that the other information to be published with the financial statements is consistent with our knowledge of your organisation and the financial statements we have audited. Our anticipated audit report opinions will be unmodified. Our proposed opinions are subject to the satisfactory resolution of the outstanding matters outlined on the following page. **Audit evidence and explanations/significant difficulties** • In some instances, delays were experienced in obtaining the information requested. This was particularly the case when the requested information originated from a source outside of the corporate finance team. A control recommendation around the effectiveness of processes in place with teams outside of corporate finance has been included at Appendix A. • In some instances, management explanations for the inputs into and assumptions behind key accounting estimates was insufficient and alternative audit procedures were required to ensure that the associated account balances were not materially misstated. A control recommendation in this regard has been included at Appendix A. We are working with management with the aim to establish a more efficient process for 2019/20 and future years.
Value for Money arrangements (Royal Borough of Kensington and Chelsea only)	Under the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report if, in our opinion, you have made proper arrangements to secure economy, efficiency and effectiveness in its use of resources ('the value for money (VFM) conclusion').	We have substantially completed our risk based review of your value for money arrangements. However, we are unable to issue our conclusion in respect of this work for 2018/19 as your predecessor auditors have not yet issued their value for money conclusions in respect of the 2016/17 and 2017/18 audits. Refer to Appendices E and F. Our findings are summarised on pages 21 to 34.

Headlines (continued)

This table summarises the key findings and other matters arising from the statutory audits of the Royal Borough of Kensington and Chelsea (‘the Council’) and Kensington and Chelsea Pension Fund (‘the Pension Fund’) and the preparation of your financial statements for the year ended 31 March 2019 for those charged with governance.

Statutory duties (Royal Borough of Kensington and Chelsea only)	The Local Audit and Accountability Act 2014 (‘the Act’) also requires us to: • report to you if we have applied any of the additional powers and duties ascribed to us under the Act; and • To certify the closure of the audit.	We have not exercised any of our additional statutory powers or duties. We have completed the majority of work under the Code but are unable to issue our completion certificate until: • we are able to issue our value for money conclusion, which cannot be issued until your predecessor auditors issue their value for money conclusions in respect of the 2016/17 and 2017/18 audits • your predecessor auditors have issued their completion certificates for the 2016/17 and 2017/18 audit years • we have completed the required work on the consistency of the pension fund annual report with the audited financial statements.

Acknowledgements

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team, management and other staff during our audit.

Summary

Overview of the scope of our audit

This Audit Findings Report presents the observations arising from the audit that are significant to the responsibility of those charged with governance to oversee the financial reporting process, as required by International Standard on Auditing (UK) 260 and the Code of Audit Practice ('the Code'). Its contents have been discussed with management.

As auditor we are responsible for performing the audit, in accordance with International Standards on Auditing (UK) and the Code, which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

Audit approach

Our audit approach was based on a thorough understanding of your business and is risk based, and in particular included:

- An evaluation of your internal controls environment, including its IT systems and controls;
- Controls testing of your pensions member data systems; and
- Substantive testing on significant transactions and material account balances, including the procedures outlined in this report in relation to the key audit risks

We have not had to alter or change our audit plan, as communicated to you in February 2019.

Conclusion

We have completed our audit of your financial statements and we anticipate issuing unqualified audit opinions, as detailed in Appendices E and F.

Our approach to materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law. Materiality calculations remain the same as reported in our audit plan. We detail in the table to the right our determination of materiality.

	Council Amount (£)	Pension Fund Amount (£)
Materiality for the financial statements	13,522,000	10,818,000
Performance materiality	9,465,000	8,114,000
Trivial matters	676,000	541,000

Significant findings – audit risks

	Risks identified in our Audit Plan	Commentary
1	**ISA240 revenue risk** (Council and Pension Fund)	Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition. As reported to you in our Audit Plan in February 2019, having considered the risk factors set out in ISA240 and the nature of your revenue streams, we determined that the risk of fraud arising from revenue recognition can be rebutted, because: • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited • the culture and ethical frameworks of local authorities, including you, mean that all forms of fraud are seen as unacceptable There have been no changes to our assessment in respect of this risk as reported in our Audit Plan.
2	**Management override of controls** (Council and Pension Fund)	We have: • evaluated the design effectiveness of management controls over journals • analysed the journals listing and determined the criteria for selecting high risk unusual journals • tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration • gained an understanding of the accounting estimates and critical judgements applied made by management and consider their reasonableness with regard to corroborative evidence • evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions. We identified that your new accounting system does not require a two-stage approval process for journal entries to be posted. However, management monitor journal postings through review of quarterly usage reports, routine sample/spot-checking of the document store and online budget monitoring. Therefore we are satisfied that sufficient controls are in place to mitigate the risk identified. Aside from this, our audit work has not identified any other material issues in respect of management override of controls.
3	**Valuation of land and buildings** (Council)	We have: • evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work • evaluated the competence, capabilities and objectivity of the valuation expert • written to the valuer to confirm the basis on which the valuation was carried out • challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding • tested revaluations made during the year to ensure that they have been input correctly into your asset register Our audit work has not identified any material issues in respect of the identified risk which would require reporting to those charged with governance.

Significant findings – audit risks

	Risks identified in our Audit Plan	Commentary
4	**Valuation of pension fund net liability** (Council)	We have: • gained an understanding of the processes and controls put in place by management to ensure that the pension fund net liability is not materially misstated, and evaluated the design of the associated controls; • evaluated the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work; • assessed the competence, capabilities and objectivity of the actuary who carried out the pension fund valuation; • assessed the accuracy and completeness of the information provided to the actuary to estimate the liability; • tested the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary; • undertaken procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report; and • obtained assurances from our audit of your Pension Fund as to the controls surrounding the validity and accuracy of membership data; contributions data and benefits data sent to the actuary by the pension fund and the fund assets valuation in the pension fund financial statements. <u>Impact of the McCloud transitional protection pensions ruling</u> The Court of Appeal ruled in December 2018 that there was age discrimination in the judges and firefighters pension schemes where transitional protections were given to scheme members. The Government applied to the Supreme Court for permission to appeal this ruling, but this permission to appeal was refused in late June 2019. The case will now be remitted back to employment tribunal for remedy. The legal ruling around age discrimination (McCloud - Court of Appeal) has implications not just for pension funds, but also for other pension schemes where they have implemented transitional arrangements on changing benefits. Discussion is ongoing in the sector regarding the potential impact of the ruling on the financial statements of Local Government bodies. Management requested estimates from their actuary of the potential impact of the McCloud ruling. The actuary's estimate was of a possible increase in past service cost and overall pension liabilities of £8,259k. In conjunction with auditor's experts, we reviewed the analysis performed by Barnett Waddingham to consider whether the approach that has been taken to arrive at these estimates is reasonable. No issues were noted in this review. There is sufficient evidence to indicate that a liability is probable, in particular in light of the Supreme Court refusal of the right to appeal the original judgement. As such, management have updated their financial statements to reflect the revised liability and service cost figures provided by their actuaries. This has resulted in changes to the draft Comprehensive Income and Expenditure Statements, Balance Sheets and Movement in Reserves Statements, as well as a number of the Notes to the financial statements including the Expenditure and Funding Analysis and explanatory note, Adjustments between Accounting Basis and Funding Basis under Regulation, Unusable Reserves and Defined Benefit Pension Schemes. This impact has been reported within 'Adjusted Misstatements' at Appendix B below.

continued…….

Significant findings – audit risks

	Risks identified in our Audit Plan	Commentary
4	**Valuation of pension fund net liability (*continued*)** (Council)	Impact of Guaranteed Minimum Pension (GMP) equalisation ruling The High Court has ruled that defined benefit pension schemes must remove any discriminatory effect that guaranteed minimum pension entitlements have had on members benefits. The Government has announced an "interim solution" for members in public service schemes, including the Local Government Pension Scheme. We performed specific work to ensure that the impact had been sufficiently included within your pensions liability calculations. We are satisfied that all material liabilities arising from the GMP ruling have been included in your balance sheet, having already been considered in the original actuarial valuations obtained for the draft financial statements, or otherwise having an immaterial impact. No amendment to the financial statements has been required as a result of this issue. Aside from this, we have not identified any material issues in respect of the valuation of the pension fund net liability which are necessary to report to those charged with governance.
5	**Incomplete or inaccurate financial information transferred to the new general ledger** (Council and Pension Fund)	We have: • completed an information technology (IT) environment review by our IT audit specialists to document, evaluate and test the IT controls operating within the new general ledger system; • reviewed your arrangements and controls for transferring data from the old financial system to the new financial system; • mapped the closing balances from the legacy general ledger system (Agresso) to the opening balance position in SAP to assess the accuracy and completeness of the financial information; and • tested the data transfer from the old system to the new, and from the new system back to the old, to gain assurance over the completeness and accuracy of data transferred. Our work in this area is now complete. No material issues were identified in respect of this risk which require reporting to those charged with governance.
6	**Accuracy and occurrence of operating expenditure relating to the Grenfell fire recovery** (Council)	We have: • gained an understanding of your system for identifying and accounting for operating expenditure relating to the Grenfell fire recovery and evaluated the design of the associated controls; • substantively sample tested operating expenditure relating to the Grenfell fire recovery to supporting documentation to gain assurance over the accuracy and occurrence of this expenditure; and • corroborated expenditure disclosed as being related to the Grenfell fire recovery to other sources of information and our wider understanding of your circumstances Our audit work has not identified any material issues in respect of the identified risk which would require reporting to those charged with governance.

Significant findings – audit risks

Risks identified in our Audit Plan	Commentary
7 **Valuation of Level 3 Investments** (Pension Fund)	We have: • evaluated management's processes for valuing Level 3 investments • reviewed the nature and basis of estimated values and consider what assurance you have over the year end valuations provided for these types of investments; to ensure that the requirements of the Code are met • for a sample of investments, tested the valuation by obtaining and reviewing the audited accounts, (where available) at the latest date for individual investments and agreeing these to the fund manager reports at that date. Reconciled those values to the values at 31 March 2019 with reference to known movements in the intervening period and • in the absence of available audited accounts, evaluated the competence, capabilities and objectivity of the valuation expert. Our audit work has not identified any material issues in respect of the identified risk which would require reporting to those charged with governance.

Other findings – audit risks

	Risks identified in our Audit Plan	Commentary
1	**Completeness of non-pay operating expenditure and associated short-term creditors** (Council)	We have: • evaluated your accounting policy for recognition of non-pay expenditure for appropriateness; • gained an understanding of your system for accounting for non-pay expenditure and evaluate the design of the associated controls; • obtained and tested a listing of non-pay payments made in April 2018 to ensure that they have been charged to the appropriate year. Our work in this area is now complete. No issues were identified in respect of this risk which require reporting to those charged with governance.
2	**Provisions and contingent liabilities** (Council)	We have: • reviewed disclosure and classification of short- and long-term provisions to ensure that they meet the requirements of the CIPFA Code and IAS 37; and • discussed with your legal advisors, reviewed committee minutes and other sources of information to gain assurance over the completeness of provisions recognised. Our work in this area is now complete. No issues were identified in respect of this risk which require reporting to those charged with governance.

Other findings – audit risks

	Risks identified in our Audit Plan	Commentary
3	**Actuarial Present Value of Promised Retirement Benefits** (Pension Fund)	We have: • updated our understanding of the processes and controls put in place by management to ensure that your Actuarial Present Value of Promised Retirement Benefits is not materially misstated and evaluated the design of the associated controls; • evaluated the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work; • assessed the competence, capabilities and objectivity of the actuary who carried out your pension fund valuation; • assessed the accuracy and completeness of the information which you provide to the actuary to estimate the liability; • tested the consistency of disclosures with the actuarial report from the actuary; • undertaken procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report. <u>Impact of the McCloud transitional protection pensions ruling</u> In light of the McCloud pensions ruling, outlined under 'Valuation of the net pension fund liability' on page 6 above, management requested their actuary to prepare updated estimates of the valuation of promised retirement benefits as at 31 March 2019, as required for disclosure in the notes to the Pension Fund Financial Statements under IAS 26. Management's actuary (Barnett Waddingham), estimated an increase in liabilities to be disclosed of £9.2m. We have reviewed the analysis performed by the actuary, and consider that the approach that has been taken to arrive at this estimate is reasonable. Management have therefore updated their IAS 26 disclosure to reflect this increased liability in the final draft of the financial statements Aside from this, no material issues have arisen during the course of our audit in respect of the risk identified.
4	**Contributions** (Pension Fund)	We have: • evaluated your accounting policy for recognition of contributions for appropriateness; • gained an understanding of your system for accounting for contribution income and evaluated the design effectiveness of the associated controls; • agreed changes in Admitted/Scheduled bodies to supporting documentation and agree total contributions for each employer to employer contributions reports • performed testing on the contribution parameters for the financial year to ensure these have been correctly updated within the Payroll System • tested a sample of contributions to source data to gain assurance over their accuracy and occurrence; and • performed a predictive analytical review with reference to changes in member body payrolls and the number of contributing pensioners to ensure that any unusual trends are satisfactorily explained. Our audit work has not identified any material issues in respect of the identified risk which would require reporting to those charged with governance.

Other findings – audit risks

	Risks identified in our Audit Plan	Commentary
5	**Pension Benefits Payable** (Pension Fund)	We have: • evaluated your accounting policy for recognition of pension benefits expenditure for appropriateness; • gained an understanding of your system for accounting for pension benefits expenditure and evaluate the design of the associated controls; • tested a sample of lump sums and associated individual pensions in payment by reference to member files; • performed a predictive analytical review with reference to changes in pensioner numbers and increases applied in year to ensure that any unusual trends are satisfactorily explained; and • ensured the annual pension increase has been updated in the system correctly Our audit work has not identified any material issues in respect of the identified risk which would require reporting to those charged with governance.
6	**Valuation of Level 2 Investments** (Pension Fund)	We have: • gained an understanding of your process for valuing Level 2 investments and evaluated the design of the associated controls; • reviewed the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments; • reviewed the reconciliation of information provided by the individual fund manager's custodian and the your own records and sought explanations for variances; • requested year-end confirmations from investment managers and custodian(s) • where necessary, tested a sample of unit values used to value level 2 investments to externally quoted information sources, or where not quoted, to unit values provided by the investment manager's own independent custodian. • for direct property investments agreed values in total to valuer's report and undertaken steps to gain reliance on the valuer as an expert. Our audit work has not identified any material issues in respect of the identified risk which would require reporting to those charged with governance.

Significant findings – key judgements and estimates

Accounting area	Summary of management's policy	Audit Comments	Assessment
Provisions for NNDR appeals - £31m (Council only)	You are responsible for repaying a proportion of successful rateable value appeals. The calculation for the provision is performed internally by the team responsible for monitoring Business Rates collection across the Borough. Your calculation is based upon the latest information about outstanding rates appeals provided by the Valuation Office Agency (VOA) and previous success rates. The provision included within the accounts has increased significantly in 2018-19 due to you taking part in the Business Rate Retention Scheme across London, which whilst increasing the level of income you receive, also means you take on more of the risk of non-collection.	• Management's calculation was based on a percentage of business rates income receivable as notified by DCLG, and increased for reasons of prudence to allow for unknown appeals. Management was not able to justify that this percentage was reasonable based on experience and likelihood of actual appeals to be raised, which is due to the lack of data available under the revised appeals scheme. • As outlined within the Action Plan at Appendix A, we recommend that management seek to better understand the basis upon which their estimates are made. • Additional audit procedures were required as a result of which we are satisfied that the provision made by management in the draft financial statements is reasonable and has not led to a material misstatement.	Green
Land and Buildings – Council Dwellings – £777m (Council only)	You own 6,701 dwellings held within your Housing Revenue Account and are required to revalue these properties in accordance with DCLG's Stock Valuation for Resource Accounting guidance. The guidance requires the use of beacon methodology, in which a detailed valuation of representative property types is then applied to similar properties. You have engaged your expert valuer, JLL, to complete the valuation of these properties. You also own 219 dwellings which are held within your General Fund. These properties were acquired to rehouse the survivors of the Grenfell Fire, and special dispensation was required from the Government to permit you to hold and manage these separately from your general housing stock. These properties have been revalued on an individual basis using Existing Use Value – Social Housing (EUV-SH). The majority of these properties were held as 'Assets Under Construction' in the prior year financial statements and were transferred into the operational 'Dwellings' class in-year, at which point the cost previously applied to the carrying value of the properties was discounted by 75% in line with EUV-SH methodology. The year end valuation of Council Housing was £777.2m, a net increase of £14.2m from 2017/18 (£763.0m).	• As outlined above, our work in this area remains ongoing. From the work performed to date, no material issues have arisen in relation to the valuation of your housing stock included within the accounts. • The valuer has correctly prepared the valuation using the stock valuation guidance issued by MHCLG, and has ensured the correct factor has been applied when calculating the Existing Use Value – Social Housing (EUV-SH) value disclosed within the accounts. • All properties have been valued as at 31 March 2019.	Green

Assessment

- Red: We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- Amber: We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- Yellow: We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- Green: We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant findings – key judgements and estimates

	Summary of management's policy	Audit Comments	Assessment
Land and Buildings – Other - £537m (Council only)	Other land and buildings comprises £234m of specialised assets such as schools and libraries, which are required to be valued at depreciated replacement cost (DRC) at year end, reflecting the cost of a modern equivalent asset necessary to deliver the same service provision. The remainder of other land and buildings (£303m) are not specialised in nature and are required to be valued at existing use in value (EUV) at year end. You have engaged JLL to complete the valuation of properties as at 31 March 2019 on a five yearly cyclical basis. 100% of total assets were revalued during 2018/19. The valuation of properties valued by the valuer has resulted in a net decrease of £52.0m. The total year end valuation of Other land and buildings was £536.7m, a net decrease of £29.4m from 2017/18 (£566.1m).	• We have assessed the valuer, JLL, to be competent, capable and objective. • We have carried out completeness and accuracy testing of the underlying information used to determine the estimate, and have no issues to report. • The valuation method remains consistent with the prior year. • We confirm consistency of estimate against the Gerald Eve report on property market trends, and reasonableness of the increase in the estimate. • We have agreed the valuation report to the fixed asset register and the financial statements.	● (green)

Assessment

- ● We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- ● We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- ● We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- ● We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant findings – key judgements and estimates

	Summary of management's policy	Audit Comments	Assessment
Net pension liability – £184m (Council only)	Your net pension liability at 31 March 2019 is £184m, after consideration of the impact of the McCloud pensions ruling outlined elsewhere in this report (PY £248m). This comprises liabilities relating to the Kensington and Chelsea Local Government Pension Fund and a share of the London Pension Fund Authority Local Government Pension Fund. You use Barnett Waddingham to provide actuarial valuations of your assets and liabilities derived from these schemes. A full actuarial valuation is required every three years. The latest full actuarial valuation was completed in 2016. A roll forward approach is used in intervening periods, which utilises key assumptions such as life expectancy, discount rates, salary growth and investment returns. Given the significant value of the net pension fund liability, small changes in assumptions can result in significant valuation movements. There has been a £64m net actuarial gain during 2018/19.	See audit comments below	

Audit Comments:

- We have assessed the actuary, Barnett Waddingham, to be competent, capable and objective.
- We have performed additional tests in relation to accuracy of contribution figures and benefits paid to gain assurance over the 2018/19 roll forward calculation carried out by the actuary. Our work in this area is in progress.
- We have used PwC as our auditor's expert to assess the actuary and assumptions made by the actuary – see table below for out comparison of actuarial assumptions:

Assumption	Actuary Value	PwC range	Assessment
Discount rate	2.40%	2.35% - 2.45%	
Pension increase rate	2.40%	2.35% - 2.45%	
Salary growth	3.90%	CPI (2.35% - 2.45%) + 1.50%	
Life expectancy – Males currently aged 45 / 65	25.0 / 23.4	22.2 - 25.0 / 20.6 – 23.4	
Life expectancy – Females currently aged 45 / 65	26.6 / 24.8	25.0 - 26.6 / 23.2 – 24.8	

- We have confirmed the controls and processes over the completeness and accuracy of the underlying information used to determine the estimate.
- We have confirmed there were no significant changes in 2018/19 to the valuation method.
- Reasonableness of increase in estimate – our work confirms that the increase in the IAS 19 estimate is reasonable.

Assessment

- We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant findings – key judgements and estimates

	Summary of management's policy	Audit Comments	Assessment
Level 3 investments (Pension fund only)	You have investments in private equity funds that in total are valued on the balance sheet as at 31 March 2019 at £61m. These investments are not traded on an open exchange/market and the valuation of the investment is highly subjective due to a lack of observable inputs. In order to determine the value, management relies on information provided by the General Partners to the private equity funds, who prepare valuations in accordance with the International Private Equity and Venture Capital Valuation Guidelines, and produce accounts to 31 December 2018 which are audited. The value of these investments has increased by £8.2m in 2018/19.	• We have assessed the appropriateness of the underlying information used to determine the estimate, including fund manager and custodian reports, and audited accounts of the private equity funds as at 31 December 2018 • We have assessed the consistency of the estimate against peers and industry practice • We have reviewed the reasonableness of the increase in the estimate • We have assessed the adequacy of disclosure of estimate in the financial statements • As noted above, our work in this area remains ongoing. Subject to the resolution of the outstanding matters detailed on page 4, we have identified no material issues to bring to the attention of those charged with governance in respect of the points above.	
Level 2 investments (Pension fund only)	You have investments in pooled funds that in total are valued on the balance sheet as at 31 March 2019 at £885m. The investments are not traded on an open exchange/market and the valuation of the investment is subjective. In order to determine the value, management make use of evaluated price feeds, with the exception of the valuation of property investments which is based on evaluation of market data. The value of these investments has increased by £120.3m in 2018/19.	• We have assessed the appropriateness of the underlying information used to determine the estimate • We have assessed the consistency of the estimate against peers and industry practice • We have reviewed the reasonableness of the increase in the estimate • We have assessed the adequacy of disclosure of estimate in the financial statements • As noted above, our work in this area remains ongoing. Subject to the resolution of the outstanding matters detailed on page 4, we have identified no material issues to bring to the attention of those charged with governance in respect of the points above.	

Assessment

- We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- We consider management's process and key assumptions to be reasonable

Significant findings – matters discussed with management

This section provides commentary on the significant matters we discussed with management during the course of the audit.

	Significant matter	Commentary
1	**Transfer of the Grenfell Tower site to MHCLG**	The freehold and legal title of the Grenfell Tower site transferred to MHCLG on 15 July 2019, who intend to create a permanent memorial. The transfer took place for a nominal payment and as such the tower and site are valued at nil in the balance sheet as at 31 March 2019. This is due to the restricted use of the site and the high volume of liabilities associated with keeping the structure safe, and eventually demolishing it, which would outweigh any value it may have. This valuation has been agreed by your external valuer and the restrictions on use have been confirmed by your monitoring officer. Management have included a non-adjusting event after the reporting period within the applicable note to the financial statements.
2	**Potential liabilities arising from the Grenfell Tower fire**	The financial statements contain no provisions in respect of potential future liabilities arising from the Grenfell Tower fire – whether resulting from the criminal investigation (which could result in the Council being charged with corporate manslaughter and facing an unlimited fine) or from civil claims. The criminal investigation is unlikely to conclude until after the conclusion of the public inquiry (which is not likely to be until the end of 2021). No civil claims have yet been lodged against you. As such, your monitoring officer and Insurance Director are of the view that the value and timing of future liabilities cannot be reliably estimated. A contingent liability has been disclosed in Note 40 to the financial statements explaining this situation. We consider management's approach to be reasonable.
3	**Dedicated Schools Grant earmarked reserve**	You have recognised a deficit reserve of £4.3m within your Earmarked Reserves balances in respect of your Dedicated Schools Grant deficit. From 2018/19, all local authorities with a cumulative Dedicated Schools Grant (DSG) deficit of 1% or more at the end of the financial year must submit a recovery plan to the Education and Skills Funding Agency, showing how they will bring the deficit into balance in a three year time frame. A joint Department for Education and CIPFA statement released in June 2019 confirms that both parties are committed to working with other stakeholders to clarify the legal basis for, and accounting treatment of, DSG deficits in time for the 2020/21 budget round and 2019/20 accounts closure. The Joint Statement also confirms that the CIPFA Local Authority Accounting Panel (LAAP) considered the issue for 2018/19 and noted concerns regarding the presentation of an earmarked deficit DSG reserve, particularly given that there is not a clearly identified legislative basis for the ring-fencing of DSG deficits. Our view is that where overspends arise against Dedicated Schools Grant and are to be carried forward as a call against the schools budget in future years, these should form part of the un-earmarked general fund. We discussed your current accounting treatment and the Joint Statement with management. Whilst the use of a negative earmarked reserve is not good practice, the net Usable Reserves position is appropriately stated. We concluded on that basis that your Usable Reserves are properly stated and that as such a user of the financial statements will be able to take an informed view of the Council's overall level of balances and reserves based on the information within the statements. We will discuss the accounting treatment with management in respect of future years once CIPFA confirm their expected treatment or any further guidance is issued by CIPFA or the Department of Education.

Going concern

Our responsibility

As auditors, we are required to "obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern" (ISA (UK) 570).

Going concern commentary

Management's assessment process

Royal Borough of Kensington and Chelsea

The Statement of Accounts has been prepared on a 'going concern' basis on the assumption that the functions of the Council will continue in operational existence for the foreseeable future

Kensington and Chelsea Pension Fund

The Pension Fund Accounts have been prepared on a going concern basis.

The CIPFA Code requires that financial statements be prepared on a Going Concern Basis:

2.1.2.6 – an authority's financial statements shall be prepared on a going concern basis; that is, the accounts should be prepared on the assumption that the functions of the authority will continue in operational existence for the foreseeable future (see also paragraph 3.4.2.23 for bodies that follow the Code but may be discontinued without statutory prescription). Transfers of services under combinations of public sector bodies (such as local government reorganisation) do not negate the presumption of going concern.

Auditor commentary

As auditors, we are required to "obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern" (ISA (UK) 570).

You continue to face significant financial challenges. Usable reserves have significantly depleted since the Grenfell fire, which has required you to reconsider your service delivery model to ensure ongoing future financial sustainability, as you have identified that £40m of recurrent savings are required to achieve a balanced budget over the next three years. You are conscious of these challenges and are introducing a refreshed approach to your medium term financial planning, with priorities for investment more closely aligned to your Council plan, and a likely restructuring of how services are delivered, from 2019/20 onwards.

Part of this has already been started, as you have moved away from the pre-existing 'tri-borough' arrangement with Westminster City Council and the London Borough of Hammersmith and Fulham, and begun to assess the model of service delivery which will be most beneficial to you on a case by case basis. Nevertheless, it is clear that your ongoing ability to deliver effective services to the residents you serve will be contingent on the success of the changes which are implemented in the near future.

Many of the potential future liabilities that you face in relation to the Grenfell tower fire are as at the time of writing, unpredictable in timing and scale. However, we are satisfied that you remain in close liaison with the relevant parties to ensure that your budgeting and forecasting are based on the most up to date information, and ensure that central support is secured where necessary.

We have reviewed in detail your 2019/20 budget and Medium Term Financial Strategy and have assessed the underlying assumptions and dependencies to be reasonable. We have also reviewed management's cashflow forecast up to 31 July 2020.

We do not consider there to be a material uncertainty which could cast doubt on either entity's ability to continue as a going concern. You hold £298m of useable revenue reserves as at 31 March 2019, and your assessment of the funding level of the Pension Fund is 95%, on the basis of the audited year-end valuation of the Fund's investment assets. This will be updated as a result of the triennial valuation, which is due later this year. At the last triennial valuation date the funding level was 103% and you are forecasting a funding level of 130% going forward. Based on this, we are satisfied that it remains appropriate for you to prepare accounts on a going concern basis as at 31 March 2019. Both the Royal Borough of Kensington and Chelsea and Kensington and Chelsea Pension Fund have a reasonable expectation that services they provide will continue for the foreseeable future. For this reason we considered it appropriate for both entities to continue to adopt the going concern basis in preparing the financial statements.

Other communication requirements

We set out below details of other matters which we, as auditors, are required by auditing standards and the Code to communicate to those charged with governance.

	Issue	Commentary
1	**Matters in relation to fraud**	• We have previously discussed the risk of fraud with the Audit and Transparency Committee. We have not been made aware of any material incidents in the period and no other issues have been identified during the course of our audit procedures.
2	**Matters in relation to related parties**	• We are not aware of any related parties or related party transactions which have not been disclosed.
3	**Matters in relation to laws and regulations**	• You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any incidences from our audit work.
4	**Written representations**	• Letters of representation have been requested from the Royal Borough of Kensington and Chelsea and Kensington and Chelsea Pension Fund, which are appended to this report.
5	**Confirmation requests from third parties**	• We requested from management permission to send confirmation requests to your banking, investment and borrowing counterparties, covering both the Royal Borough of Kensington and Chelsea, and Kensington and Chelsea Pension Fund. This permission was granted and the requests were sent. As at the date of writing, we are still awaiting responses to a number of these requests and have requested management assistance in chasing for these. • We requested from management permission to send letters to those solicitors who worked with you during the year. Responses were duly received and no issues were noted.
6	**Disclosures**	• A number of presentational, misclassification, disclosure and narrative amendments were made to the draft financial statements. These are detailed in appendices B and C.
7	**Audit evidence and explanations/significant difficulties**	• All information and explanations requested from management has been provided, with the exception of the outstanding items detailed on page 4. • In some instances, delays were experienced in obtaining the information requested. This was particularly the case when the requested information originated from a source outside of the corporate finance team. A control recommendation around the effectiveness of processes in place with teams outside of corporate finance has been included at Appendix A. • In some instances, management explanations for the inputs into and assumptions behind key accounting estimates was insufficient and alternative audit procedures were required to ensure that the associated account balances were not materially misstated. A control recommendation in this regard has been included at Appendix A.

Other responsibilities under the Code

	Issue	Commentary
1	**Other information**	We are required to give an opinion on whether the other information published together with the audited financial statements (including the Annual Governance Statement, Narrative Report and Pension Fund Financial Statements), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. No inconsistencies have been identified.
2	**Matters on which we report by exception**	We are required to report on a number of matters by exception in a numbers of areas: • If the Annual Governance Statement does not meet the disclosure requirements set out in the CIPFA/SOLACE guidance or is misleading or inconsistent with the other information of which we are aware from our audit • If we have applied any of our statutory powers or duties We have nothing to report on these matters.
3	**Specified procedures for Whole of Government Accounts**	We are required to carry out specified procedures (on behalf of the NAO) on the Whole of Government Accounts (WGA) consolidation pack under WGA group audit instructions. As the Council exceeds the specified group reporting threshold of £500m, we examine and report on the consistency of the WGA consolidation pack with the Council's audited financial statements. This work is underway, and will be completed in advance of the deadline of 13 September 2019.
4	**Certification of the closure of the audit**	We have completed the majority of work under the Code but are unable to issue our completion certificate until: • we are able to issue our value for money conclusion, which cannot be issued until your predecessor auditors issue their value for money conclusions in respect of the 2016/17 and 2017/18 audits • your predecessor auditors have issued their completion certificates for the 2016/17 and 2017/18 audit years • we have completed the required work on the consistency of the pension fund annual report with the audited financial statements.

Value for Money

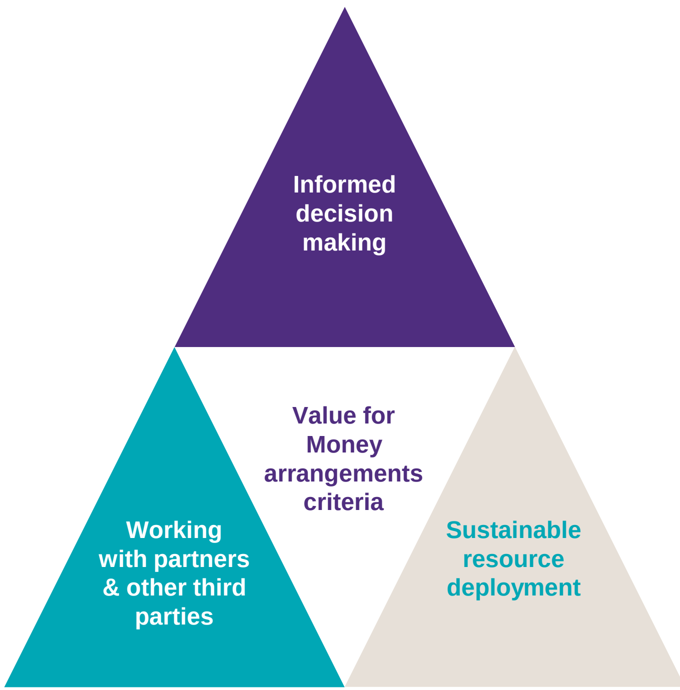
Background to our VFM approach

We are required to satisfy ourselves that you have made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the Value for Money (VFM) conclusion.

We are required to carry out sufficient work to satisfy ourselves that proper arrangements are in place. In carrying out this work, we are required to follow the NAO's Auditor Guidance Note 3 (AGN 03) issued in November 2017. AGN 03 identifies one single criterion for auditors to evaluate:

“In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.”

This is supported by three sub-criteria, as set out below:



Risk assessment

We carried out an initial risk assessment in January 2019 and identified a number of significant risks in respect of specific areas of proper arrangements using the guidance contained in AGN03. We communicated these risks to you in our Audit Plan dated February 2019.

We have continued our review of relevant documents up to the date of giving our report, and have not identified any further significant risks where we need to perform further work.

We carried out further work only in respect of the significant risks we identified from our initial and ongoing risk assessment. Where our consideration of the significant risks determined that arrangements were not operating effectively, we have used the examples of proper arrangements from AGN 03 to explain the gaps in proper arrangements that we have reported in our VFM conclusion.

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Value for Money

Our work

AGN 03 requires us to disclose our views on significant qualitative aspects of the Council's arrangements for delivering economy, efficiency and effectiveness.

We have focused our work on the significant risks that we identified in the Council's arrangements. Our main considerations were:

- Financial outturn for 2018/19
- Budget for 2019/20
- Medium Term Financial Strategy for the next three years, including underlying assumptions and forecast savings plans
- Comparative financial data for the Royal Borough of Kensington and Chelsea in relation to other London Borough Councils
- Grenfell Recovery Strategy and findings of the Grenfell Recovery Taskforce and Centre for Public Scrutiny
- Council Plan
- Outcomes-based budgeting

We have set out more detail on the risks we identified, the results of the work we performed, and the conclusions we drew from this work on pages 23-34.

Overall conclusion

We have substantially completed our risk based review of your value for money arrangements. However, we are unable to issue our conclusion in respect of this work for 2018/19 as your predecessor auditors have not yet issued their value for money conclusions in respect of the 2016/17 and 2017/18 audits.

As a consequence of ongoing external investigations and inquiries, we have not yet been able to complete the work that we have determined necessary to form a view on whether, in all significant respects, the Royal Borough of Kensington and Chelsea has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2019.

The text of our report which confirms this can be found at Appendix E.

Recommendations for improvement

We discussed findings arising from our work with management and have agreed recommendations for improvement.

Our recommendations and management's response to these can be found in the Action Plan at Appendix A

Significant difficulties in undertaking our work

We did not identify any significant difficulties in undertaking our work on your arrangements which we wish to draw to your attention.

Significant matters discussed with management

There were no matters where no other evidence was available or matters of such significance to our conclusion or that we required written representation from management or those charged with governance.

Delay in issuing of conclusion

Your predecessor auditors have not yet issued conclusions for 2016/17 or 2017/18. In their audit findings report in 2017/18 they stated

"*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 whereupon 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*."

Once your predecessor auditors have issued their prior year conclusions, we will consider the impact of these with a view to finalising our own conclusions in respect of the 2018/19 VFM conclusion.

Key findings

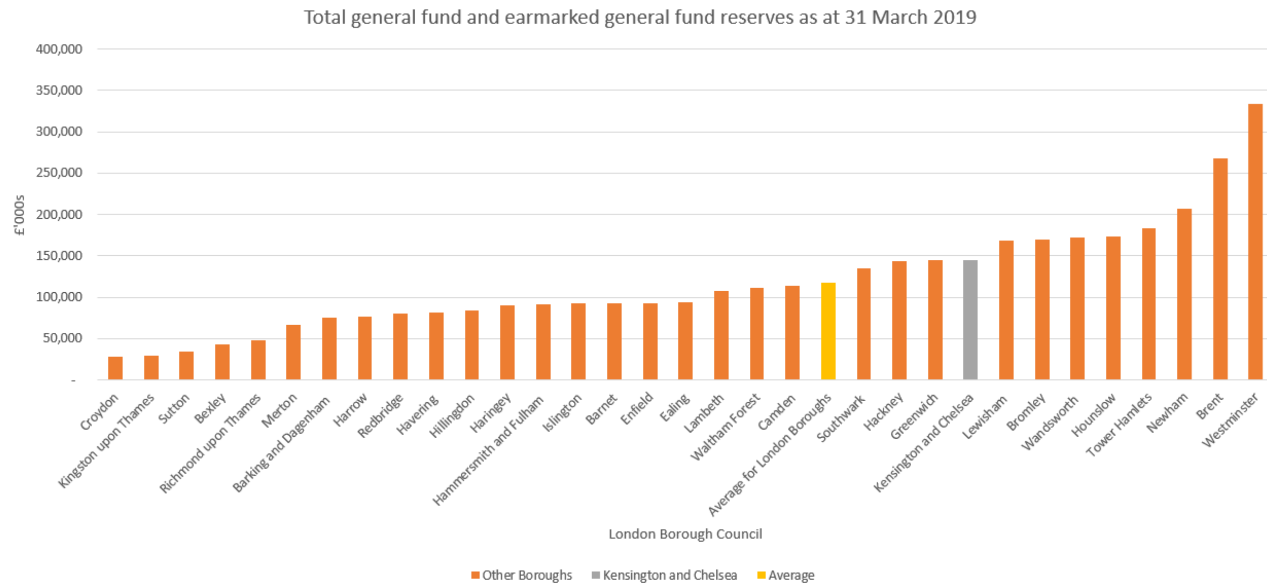
We set out below our key findings against the significant risks we identified through our initial risk assessment and further risks identified through our ongoing review of documents.

	Significant risk	Findings and Conclusion
1	**Medium Term Financial Planning** In the context of tightening central government funding over recent years and a reduction in useable reserves as a result of the expenditure required to respond to the Grenfell fire, in the medium term you will be required to make significant savings in areas where these have not previously been necessary, in order to maintain financial balance. We will review your Medium Term Financial Strategy and examine underlying assumptions and dependencies for robustness. We will examine in detail the savings plans aimed at reducing future funding gaps.	<u>2018/19 outturn</u> In 2018/19 you reported a net revenue underspend of around £10 million. This comprised an overspend in Children's Services demand-led services offset by overperformance in parking income and an unbudgeted section 31 grant. Whilst this is a success in achieving a balanced budget in-year, the key inputs into this net position do not represent sustainable savings in the medium-term and cannot be relied upon to maintain ongoing financial balance. In particular, it will be crucial that pressures in respect of demand-led services are effectively managed. This has been considered specifically in relation to your Dedicated Schools Grant expenditure later in this report. In addition, the variances for individual services and overall suggest there is scope for improvement in the robustness and accuracy of assumptions used in setting budgets. Slippage in your capital programme also led to unbudgeted savings in relation to the revenue costs associated with capital financing. Going forward, you are aiming to more accurately forecast and plan for areas such as these based on historic knowledge and the information available to you. This will help to ensure that savings and cuts to services are not made where these can be avoided. Your capital programme, which was initially set at £116m, underspent by £39m in the year. You have commissioned an internal audit review into your underperformance against your capital budget to help in identifying whether the underlying causes relate primarily to deficiencies in the planning process or to ineffective on-the-ground delivery, and to enable you to put in place measures to address this in the future. One of the key pressures on your capital budget is the redevelopment of the Lancaster West estate. You have contributed £15m to date to this project which has been matched by MHCLG. You remain in continued dialogue with the Department to ascertain future contributions from both parties, to ensure a satisfactory solution. Should these contributions from central government not be provided, use of reserves would be required to meet your commitments to the residents of the estate. This would significantly impact upon your ability to meet your other medium-term goals, supporting all communities which you serve. This feeds into wider pressures on your overall HRA capital programme, which is set at £268m over the next seven years. <u>2019/20 budget</u> A balanced budget has been set for 2019/20 and the detailed planning in respect of 2020/21 is already underway. This is part of the wider process of reviewing your Medium Term Financial Strategy, which will begin more thoroughly in July. In respect of 2019/20, the maximum increase in Band D Council Tax of 2.99% and 2% for the adult social care precept was approved by the Council in March 2019. This is only the third Council Tax increase in ten years and is the first time you have implemented the adult social care precept, reflecting the more challenging environment in which you are now operating. Despite this, in your medium-term budget you have resolved to retain Council Tax within the lowest quartile within London. You have been prudent in not including any forward assumptions around the potential benefits to RBKC of the new London business rates pooling arrangements, since the scale of these will not be evident until all of the London Boroughs and the GLA have closed their 2019/20 financial statements. There is also a risk that, in future years, you may be liable for additional costs arising from this arrangement.

Significant risk	Findings and Conclusion
1 **Medium Term Financial Planning** In the context of tightening central government funding over recent years and a reduction in useable reserves as a result of the expenditure required to respond to the Grenfell fire, in the medium term you will be required to make significant savings in areas where these have not previously been necessary, in order to maintain financial balance. We will review your Medium Term Financial Strategy and examine underlying assumptions and dependencies for robustness. We will examine in detail the savings plans aimed at reducing future funding gaps.	You have taken back ownership for management of your social housing stock from March 2018. You are aware in terms of short and medium-term planning that the Tenant Management Organisation, which was previously responsible for this, requires sufficient resources to continue to respond effectively to the ongoing public inquiry into the Grenfell fire, and have factored this in to the budget-setting process within both 2019/20 and beyond. The 2019/20 budget includes £12.4m of growth and service pressures, as well as an £8.4m savings requirement. The savings plans were comprehensively identified and approved by members in January 2019, having been through several rounds of scrutiny. However, the 2019/20 budget also includes £9m of one-off contributions which you acknowledge will not be sustainable going forwards. You are looking to redesign your medium-term budget-setting process for 2020/21 and beyond. <u>Medium-term forecasting and planning</u> As part of your wider cultural transformation you are looking to initiate a new outcomes-based approach to investing in and delivering on priorities, and using this to formulate a sustainable medium term financial strategy. This will mean that budgeting from 2020/21 onwards should become more closely aligned to your new corporate plan as outlined to the leadership team in March 2019. This approach and the likely dependencies are explored further during 'Cultural Change and Transformation' below. The change in approach will be instrumental in ensuring that the future challenges, including a £40m savings requirement in the three years from 2020/21, are achievable. These need to be delivered in the context of demand pressures which could be faced, in conjunction with retaining an adequate level of useable reserves in line with the reserves policy. Key assumptions underpinning your medium-term forecast are: • Pay and price inflation of 2% for pay and the Council's major contracts per annum in future years. • Funding reductions as set out in the latest (2019-20) local government finance settlement. Government is currently consulting on a new national funding formula that will determine the baseline level of need and therefore the level of business rates retained. • An increase in business rates (NNDR) income each financial year (to keep the Council above the Government's funding distribution system threshold and also cover the annual increase in the cost of the tariff). The Council is part of year 2 of the London pooling pilot. Government is currently consulting on changes to the Business Rates scheme from 2020 which will roll out 75% Business Rates Retention across the country. • A modest increase in the Council Tax base each year of 480 properties per annum. • It is assumed that any reductions in service specific grants can and will be contained within service budgets. • An increase in Council tax in line with inflation and the assumed referendum limit (2.99%) These assumptions are reasonable and are consistent with those being applied across the sector. They will be revisited in the refresh of the MTFS from 2020/21-2023/24 which will take place in July, to determine whether they remain the most appropriate for your current circumstances based on the information available to you. This will be particularly pertinent as further information comes to light over the next 12 months, in particular in relation to the revised funding formula. You have also clearly identified a number of risks impacting the reliability of the forecast and achievability of your plans, including uncertainties relating to the government's national funding formula review, Brexit and potential future liabilities relating to the outcome of the Grenfell fire public inquiry. Changes in the structure of the Better Care Fund have also been noted as a risk as a result of the financial contributions being made by other parties, including West London CCG, becoming less clear. These risks have been openly communicated within the leadership team, committee structures and full Council settings, and the implications are being carefully worked through, including requirement for service redesign to make meeting the potential challenges faced manageable.

	Significant risk	Findings and Conclusion
1	**Medium Term Financial Planning** In the context of tightening central government funding over recent years and a reduction in useable reserves as a result of the expenditure required to respond to the Grenfell fire, in the medium term you will be required to make significant savings in areas where these have not previously been necessary, in order to maintain financial balance. We will review your Medium Term Financial Strategy and examine underlying assumptions and dependencies for robustness. We will examine in detail the savings plans aimed at reducing future funding gaps.	Aside from the overarching outcomes-based budgeting programme, you have a number of cross-cutting corporate driven projects already underway which are expected to deliver savings but have not yet been incorporated into specific medium-term planning. These range from enhanced use of technology/review of customer contact to streamline services within the newly-sovereign Environment directorate, consideration of income generation opportunities including different ways for payments to be made, making the most beneficial use of your investment and community property assets, review of commissioning processes, overall review of customer contact and access platforms, and encouraging independence and self-sufficiency within the wider community incorporating voluntary and community sector. It will be important that, in relation to these projects, anticipated monetary benefits are identified using the available information and can be effectively monitored to gain assurance that assumptions applied remain reasonable. Since in recent years you have not faced the kind of financial challenges which have been prevalent in other local authorities, within London and beyond, there is a risk that the organisation as a whole will not be prepared for the on-the-ground impact which the necessary savings engrained in the change of approach will require. Whilst your leadership team have extensive experience of delivering financial savings and transforming the way services operate to encourage increased efficiency and better outcomes for local communities within other local authority settings, the key will be to model this and communicate clearly across the organisation to ensure that the wider team are conscious of the way they are working and that agreed protocols are followed. Refer also to further analysis below under 'Cultural Change and Transformation' risk. Reserves position As set out in the 2018/19 outturn and 2019/20 detailed budget, some use of reserves to fill funding gaps has been approved in each year, and further reserves use has been approved in the medium term for invest to save initiatives (£2.7m) and £10m for the creation of a re-organisation reserve (transferred from special projects). Whilst the 2019/20 budget has been mapped out with as much certainty as possible, you are conscious that there are some demand pressures and other spend and income issues which cannot be specifically foreseen, and as such – as in previous years – you continue to hold a central contingency budget of £5.5m to address any issues arising in-year. This also protects your general fund position, which is maintained at £10m. It is not proposed to reduce or remove the contingency provision and any unused amounts will be allocated to specific budgets to deal with future fluctuations. In respect of forecast legacy costs associated with the Grenfell fire recovery, as at 31 March 2019 you have set aside £49m in a dedicated Grenfell revenue reserve, which is to be used to fund the ongoing costs associated with the Grenfell recovery programme. You also have £6m contribution to this service built in to your rolling base budget. However you acknowledge that using reserves to fund ongoing costs relating to the Grenfell service and responses required to the inquiry, and any subsequent claims you may face, will not be a sustainable model. You also acknowledge that, as a local authority serving the entirety of the borough, you have a responsibility to residents to maintain reserves for future investment across your remit. A review was conducted by CIPFA during Spring 2019 to assess your capacity to meet the ongoing costs from your own resources, including use of reserves and future increases in levels of local taxation. You have received indication that CIPFA concur with your view that significant recurrent central government funding will be required to enable liabilities to be met and for you to maintain capacity to provide effective services in other areas to the communities you serve.

Significant risk	Findings and Conclusion
❶ **Medium Term Financial Planning** In the context of tightening central government funding over recent years and a reduction in useable reserves as a result of the expenditure required to respond to the Grenfell fire, in the medium term you will be required to make significant savings in areas where these have not previously been necessary, in order to maintain financial balance. We will review your Medium Term Financial Strategy and examine underlying assumptions and dependencies for robustness. We will examine in detail the savings plans aimed at reducing future funding gaps.	The practical realities of this funding are at present uncertain, not least due to the current Conservative leadership contest and potential for the appointment of a new secretary of state. In relation to the Dedicated Schools Grant, you are currently carrying a cumulative deficit of £4.3m, which is largely due to overspends in the previous three years on services provided from the High Needs Block (HNB). Your 2019/20 budget reduces the overspend in-year to £0.75m although this is one of the most unpredictable elements of your budget given the demand-led nature of the services provided from the HNB. Whilst this funding is outside of your direct control, unless the cumulative deficit is recovered in future years this could form a call on your other usable reserves which will need to be considered within budget-setting in the medium term. You have prepared and submitted to the Department for Education a Deficit Recovery Plan which projects the situation improving over the medium-term. You have worked closely with the Schools Forum to carefully consider your options for delivering services differently, whilst taking into account the changes in complexity of the demand pressures which you are likely to face. Despite the pressures on your reserves which have arisen over recent years, you retain a relatively healthy position in comparison with other London Borough Councils, in particular those of a comparable size, as illustrated by the graph below:



The following table sets out a summary of your reserves position and key financial ratios as at 31 March 2019 relative to other London Boroughs as per their draft published financial statements for 2018/19:

Significant risk	Findings and Conclusion

1 **Medium Term Financial Planning**

In the context of tightening central government funding over recent years and a reduction in useable reserves as a result of the expenditure required to respond to the Grenfell fire, in the medium term you will be required to make significant savings in areas where these have not previously been necessary, in order to maintain financial balance.

We will review your Medium Term Financial Strategy and examine underlying assumptions and dependencies for robustness. We will examine in detail the savings plans aimed at reducing future funding gaps.

Kensington and Chelsea 2018/19

Measure	Kensington and Chelsea	Average for London Boroughs	Ranking relative to other London Boroughs (/32)
Total general fund and non-schools earmarked general fund reserves as at 31 March 2019 (£'000s)	144,272	106,462	6
Total general fund and earmarked general fund reserves as at 31 March 2019 (£'000s)	145,474	118,126	7
General fund and non-schools earmarked general fund reserves as a percentage of net service revenue expenditure (%)	37%	42%	14

Kensington and Chelsea 2017/18

Measure	Kensington and Chelsea	Average for London Boroughs	Ranking relative to other London Boroughs (/32)
Total general fund and non-schools earmarked general fund reserves as at 31 March 2018 (£'000s)	132,696	97,064	6
Total general fund and earmarked general fund reserves as at 31 March 2018 (£'000s)	135,737	108,873	8
General fund and non-schools earmarked general fund reserves as a percentage of net service revenue expenditure (%)	43%	48%	13

This analysis supports the view that you have successfully maintained your overall resilience levels compared to 2017/18, relative to other London Boroughs, which is testament to your ability to have maintained a relatively stable position despite an increasingly challenging financial environment.

Conclusion

Whilst in the medium-term the financial outlook is more challenging than it has been in previous years and has potential for volatility in relation to macro-economic and national political factors beyond your direct control, we are satisfied that arrangements are in place to support your medium term financial sustainability. We are therefore satisfied that this risk has been sufficiently mitigated.

	Significant risk	Findings and Conclusion
2	**Grenfell Fire – Response to Recovery** During the course of 2018/19 your work with the local community in respect of the aftermath of the Grenfell fire has shifted from immediate response to a focus on sustained recovery. In particular, you have placed emphasis on community engagement and focus groups, as the public inquiry into the fire remains ongoing. Whilst, as at the close of 2018, the vast majority of affected families have been successfully rehoused, the fire and its aftermath will have ongoing financial and wider implications on your resources for the foreseeable future. We will evaluate your ongoing strategies and arrangements for leading the recovery from the fire and your assessments of the financial and wider impact.	<u>Your commitments</u> Following the tragic events of the Grenfell Tower fire, you have invested over £50 million and employed over 300 officers to form a dedicated Grenfell directorate. Housing in respect of survivors of the fire is managed separately to your general housing management function and different protocols have been established in relation to issues around the fire safety of the properties in which they are now housed, as well as available choice of accommodation. A new political leadership was elected in May 2018 and Grenfell Recovery remains firmly top of members' agenda. In July 2018 your 'Commitments to those affected by the Grenfell Tragedy', jointly devised along with local NHS partners, was published, setting out aims and commitments to survivors, the bereaved and the wider community. It identifies long and medium-term outcomes to 2027 and formed the basis for further conversations with the community in relation to the development of a Grenfell Recovery Strategy. More recently, Grenfell Recovery is also the first of five priority areas for you as an organisation in the recently-published Council Plan. <u>Grenfell Recovery Strategy</u> You approved, in January 2019, a 5-year Grenfell Recovery Strategy, with progress being reported to the leadership team and Council on a periodic basis. Whilst this is the response in the immediate to medium term, you remain conscious that due to the nature of the events, some of the survivors and families of those affected will require a lifetime of support. The Strategy is built on a basis of local, national and international evidence relating to disaster recovery. It acknowledges that the Council alone cannot meet the needs of those affected by the Grenfell tragedy, but will work closely with partners in the health sector, voluntary and community groups, central government and residents themselves to work towards delivering its aims. The Recovery Strategy focuses on the social, economic and environmental issues faced and outlines: • Plans for a dedicated service for the bereaved and survivors, which has been co-designed with those affected to influence the structure and culture, and encompasses practical, emotional, physical and health support; • Plans to support the wider community, including ongoing support to those affected and a community programme for the local area focused on building community capacity; • A range of wider initiatives across the Council which will support recovery, including reinvigoration of the housing support service as well as commitment to implementing the recommendations set out by the Centre for Public Scrutiny, which are further explored under 'Cultural Change and Transformation', below. From October 2017 you established a Grenfell Recovery Scrutiny Committee, with the purpose to provide scrutiny and oversight for 'all decisions, policies, strategies, services and issues relating to the Grenfell Recovery programme'. A review of scrutiny arrangements is currently underway, with revised structures to be considered by the full Council in late July 2019. These will continue to include a forum for scrutiny of decisions relating to the Grenfell recovery. Now that the Recovery Strategy is in place, it will be crucial to ensure that the first of these objectives comes to fruition, and that sufficient challenge is given to ensure transparency in reporting the progress made, and maintain a relationship of trust with the various interested parties.

	Significant risk	Findings and Conclusion
2	**Grenfell Fire – Response to Recovery** During the course of 2018/19 your work with the local community in respect of the aftermath of the Grenfell fire has shifted from immediate response to a focus on sustained recovery. In particular, you have placed emphasis on community engagement and focus groups, as the public inquiry into the fire remains ongoing. Whilst, as at the close of 2018, the vast majority of affected families have been successfully rehoused, the fire and its aftermath will have ongoing financial and wider implications on your resources for the foreseeable future. We will evaluate your ongoing strategies and arrangements for leading the recovery from the fire and your assessments of the financial and wider impact.	Engagement with those affected Engagement with the survivors of the fire and bereaved families has understandably been complex for you during the period since the fire, not least due to the high level of media, public and national political interest surrounding these events. You are communicating with key stakeholders, including Grenfell United, and the inquiry members themselves, and holding dialogue around issues such as the progress of the public inquiry and the proposed review of the propriety of decision-making in place in relation to property management. The first phase of the inquiry focused on the events of the 14 June 2017 itself and the findings are unlikely to provide conclusive evidence around accountability. The second phase of the inquiry will necessarily involve more detailed investigation into the involvement of the various parties, including corporate entities with significant legal representation. As such, in addition to the pressure on the inquiry team to ensure that the conclusions reached are balanced, reasonable and accurate, this is unlikely to be a process which is resolved in a short time-frame. In this context, effective engagement with those affected will continue to be essential. Added to this, you are currently midway through the legal process of transferring the site of the Tower to MHCLG for the creation of a permanent memorial. Heads of Terms were agreed in February 2019. However, works have been required to make the structure secure in advance of the transfer taking place. This is likely to lead to further delays in the creation of a visible symbol of commemoration of those who lost their lives and were affected. Inquiry and investigation The public inquiry into the Grenfell Fire, in which you are a core participant, remains ongoing and will not conclude for several years. The first phase is now complete and you are awaiting the detailed report on findings. The second phase is due to commence in mid-2020. It is likely that a number of parties may face liability for the loss of life and physical and / or emotional trauma endured by those affected. Your insurance team has been enhanced and is working through the implications of the potential future claims and associated liabilities. Due to the stage of progress of the inquiry, it is not currently feasible to reliably estimate the scale of the costs faced, although it is possible that this could be greater than your indemnity limit of £50 million. Following the conclusion of the inquiry, legacy costs are anticipated to span for a number of years. There are plans in place to partially mitigate this through investment in rehabilitation initiatives but, given the unprecedented nature of the fire and its aftermath, the impact of this is unlikely to be quantified in the short- or medium-term. The criminal investigation into the fire is being conducted by the Metropolitan Police concurrent to the public inquiry. Although no criminal charges will be brought until after the conclusion of the public inquiry, which will be at least 2021, the investigation could, under one scenario, result in the Council being charged with Corporate Manslaughter, which currently carries a penalty of an unlimited fine. The future The third report of the Independent Grenfell Recovery Taskforce, published in December 2018, whilst critical of some of the decision making which had been in place earlier on in the response and recovery process, commended the improvements which have been made in leadership and culture: *We have seen a growing willingness from RBKC to take on board our suggestions and meet our challenges constructively. The leadership of the Chief Executive has been particularly instrumental in this. This is welcomed as a sign of increasing cultural change amongst Councillors and Officers… There are some signs that the organisation is beginning to reinvent itself.*

	Significant risk	Findings and Conclusion
2	**Grenfell Fire – Response to Recovery** During the course of 2018/19 your work with the local community in respect of the aftermath of the Grenfell fire has shifted from immediate response to a focus on sustained recovery. In particular, you have placed emphasis on community engagement and focus groups, as the public inquiry into the fire remains ongoing. Whilst, as at the close of 2018, the vast majority of affected families have been successfully rehoused, the fire and its aftermath will have ongoing financial and wider implications on your resources for the foreseeable future. We will evaluate your ongoing strategies and arrangements for leading the recovery from the fire and your assessments of the financial and wider impact.	Some of the ways in which you have begun to do this are further explored within the work addressing the third significant Value for Money risk around Cultural Change and Transformation. What is essential, as you yourselves have identified, is that you seek to become a forward and outward-looking organisation to best meet the challenges you will inevitably be presented with over coming years. **Conclusion** Due to the continuing uncertainties around the public inquiry and criminal investigation into the Grenfell fire, and as your predecessor auditors have not yet issued their VFM conclusions for 2016/17 and 2017/18, we are not yet to draw definitive conclusions around the arrangements in place and their sufficiency to secure economy, efficiency and effectiveness in the medium term.

Significant risk	Findings and Conclusion
3 **Cultural Change and Transformation** Following the cultural impact of the Grenfell fire, the ongoing evolution of the pre-existing Tri-Borough arrangement and the wider circumstances in which you are now operating as an organisation, you acknowledge that change and transformation within the Council will be required to meet the future financial and operational challenges which you face. We will review your plans for implementing cultural change and arrangements for designing, implementing and monitoring any specific programmes for embedding your strategic objectives through transformation and change.	Change at the Council In July 2018, the Centre for Public Scrutiny (CfPS) concluded an independent review of your governance arrangements that was conducted at the request of members. Their report, 'Change at the Council' identified 12 principles for you to consider adopting in your vision to become a more forward and outward-looking organisation, rebuilding trust and to allow you to be equipped to understand and meet the needs of all of your residents. These underlying principles were: 1. Connecting with residents 2. Focusing on what matters 3. Listening to every voice 4. Acting with integrity 5. Involving before deciding 6. Communicating what we're doing 7. Inviting residents to take part 8. Being clearly accountable 9. Responding fairly to everyone's needs 10. Working as a team 11. Managing responsibly 12. Having the support we need The CfPS report went on to make a series of short and long-term recommendations for building foundations for change, around the themes of involvement of local people in decision making, working more closely with the community to hold a borough-wide conversation, and drawing on best practice from across the local government sector. A key part of the commitment made in the Grenfell Recovery Strategy, published in January 2019, is to implement these recommendations and launch an area governance review, with a revised approach to decision-making, informed by local people. This process has commenced and is being regularly monitored by the various scrutiny committees. In addition to the CfPS review, culture change across the organisation was considered as being an essential component of your recovery journey in the wake of the Grenfell Tower tragedy by the independent Grenfell Taskforce. As such, in September 2018, new corporate values were adopted and approved for officers and members, based on the feedback from the CfPS and the Taskforce and a subsequent re-examination of the way in which you were previously operating as an organisation. The new values are underpinned by 'putting communities first', 'respect', 'integrity' and 'working together', and include behaviours associated with each value as well as outcomes for the community. This represents a more personal approach than was previously undertaken and focuses more on culture than on practicality. As these behaviours become embedded, it is hoped that these will help to support the implementation of the wider cultural change programme. As part of your commitment to inclusivity and community engagement, in conjunction with partners you are also developing a borough-wide economic strategy with the aim to 'support all residents to enjoy the benefits that a burgeoning London economy can bring'. This will be published during the summer and will be directly informed by consultation carried out for the Council Plan, Grenfell Recovery Strategy and Youth Review, with the strategy's development and implementation overseen by a partnership board.

Significant risk	Findings and Conclusion
3 **Cultural Change and Transformation** Following the cultural impact of the Grenfell fire, the ongoing evolution of the pre-existing Tri-Borough arrangement and the wider circumstances in which you are now operating as an organisation, you acknowledge that change and transformation within the Council will be required to meet the future financial and operational challenges which you face. We will review your plans for implementing cultural change and arrangements for designing, implementing and monitoring any specific programmes for embedding your strategic objectives through transformation and change.	<u>Council Plan and budgeting for the future</u> As noted under 'Medium Term Financial Planning' above, from 2020/21 you are implementing an outcomes-based approach to budget-setting in the medium-term, centred around your recently-published Council Plan. Five priority areas are identified in the Council Plan: (1) Grenfell recovery (2) A great place to live, work and learn (3) Supporting and safeguarding vulnerable residents (4) Healthy, clean and safe (5) A place of culture to visit and explore This focus on priorities and outcomes is a move away from how budgets and spend on activities have previously been determined. Rather than directorate-focused development of spending or income plans within allocated budget limits, the new approach will both enable and necessitate cross-service working to ensure that spend is directed effectively towards the outcomes which matter most to you and the communities you serve, and that savings are realised where possible. This will in turn require a cultural refocusing within the organisation. The delivery of the change programme will comprise of three phases: (1) Introduction and ambition-setting – this entails a review of spend against your Council Plan outcomes to identify the elements of high spend which arise from a policy decision and those which arise from inefficiencies (2) Idea generation – this will develop a range of options for redesigning services and take forward 10 key workstreams identified as a leadership team. You are conscious that whilst identifying savings is a key factor, the primary aim of the process is setting out the services which will be delivered and how this will be done to achieve the Council Plan outcomes. (3) Business case development – which will take forward ideas developed into a formal business case (including costing and modelling) which can be presented as draft savings proposals for 2020/21. This phase will require close consultation with officers across the organisation to ensure the realism and challenge of each option, development of implementation plans and profiling of investment and savings. <u>Programme management of change</u> As you do not have an in-house programme management office, external consultants either have been or will be procured to assist with each phase, with the whole process due to be completed by early September when detailed proposals will be presented to members in advance of consultation with the community as part of the 2020/21 budget-setting process. This will therefore be a fast-moving process and it will be important to ensure that despite the tight deadlines, conclusions drawn and actions from each stage are carefully considered and that governance responsibility for decision-taking is robustly documented. Despite the use of external support, internal ownership for the ensuing business model will be critical to its success and lasting impact on the culture of the organisation. As things stand, you acknowledge that whilst corporate oversight in relation to budgetary responsibility is improving – with some notable successes for instance in relation to demand-level modelling for Adult Social Care based on activity data and projections – there is still some way to go in relation to ownership being taken across the organisation for cultural change and associated budget control.

	Significant risk	Findings and Conclusion
3	**Cultural Change and Transformation** Following the cultural impact of the Grenfell fire, the ongoing evolution of the pre-existing Tri-Borough arrangement and the wider circumstances in which you are now operating as an organisation, you acknowledge that change and transformation within the Council will be required to meet the future financial and operational challenges which you face. We will review your plans for implementing cultural change and arrangements for designing, implementing and monitoring any specific programmes for embedding your strategic objectives through transformation and change.	From a finance perspective, you are conscious of the interdependencies related to your future planning and forecasting, for instance how current demand and activity within Children's Services may impact upon Adults Social Care and Housing needs in the medium-term. Understanding this future demand as thoroughly as is possible will be key to ensuring that the wider service redesign programme is focused in such a way to meet the intended objectives. Addressing potential challenges of implementation You are aware that staff communication and engagement with the service redesign programme is vital to its success, and that critical factors will be the profile of the programme and its visibility. Plans are in place to consult with front-line staff to determine their views on workable new delivery models, with the details regarding format yet to be finalised. Furthermore you are proposing to establish a Transformation and Innovation Board to encourage innovative ideas from across the board to be funded from an amount set aside for invest to save initiatives. You recognise also that given this is the first time challenging operational and spending decisions of this nature have been required, member engagement will also be key. Whilst the formal budget proposals will not be presented to members for decision-making until September, there will be a number of earlier touch points and discussions, including networking with members from other authorities which have undertaken similar programmes of change. Governance structures are in the process of being established but will include five priority-based working groups which will focus on each area of the Council Plan, cross-cutting project boards which will be chaired by Resources and Assets Directors, EMT being re-established as a Futures Board on a monthly basis, implementation of standardised project documentation and reports. Our review of the initial plans in place indicate that the progress to date has been made on a firm foundation. This includes extensive engagement with communities and partners in respect of the formulation of the Council Plan priorities, which represents the development of a clear vision in respect of what you are looking to achieve as an organisation, identification of risks relating to external political and macroeconomic factors in your medium-term planning process, and plans in place to better understand your current costs and potential for improvement on the basis of the needs of the populations you serve. However, given that the project is in an early stage, a high degree of its success will be contingent on whether the plans in place can be realised with the required level of oversight and review within the projected timeframes. Whilst it will be important in terms of achieving the necessary budget savings from 2020/21 to implement some changes in the near future, an incremental approach will be favourable in terms of ensuring that practices become embedded and part of the norm, providing the cultural environment the space to transition alongside. Once the change programme is delivered and the business cases have been approved by members, it will be crucial that a comprehensive delivery plan is devised, with resources and responsibilities appropriately allocated, to ensure that changes are implemented as intended and progress and benefits are effectively monitored and evaluated. Leadership capacity One potential additional challenge is highlighted in the third report of the Independent Grenfell Recovery Taskforce, published in December 2018, which questions whether the ongoing public inquiry, criminal investigation and more recent concerns around contamination of the soil could divert the attentions of senior Councillors and Officers which could otherwise have been used in driving forward the delivery of the Recovery Strategy and embedding cultural change and transformation.

	Significant risk	Findings and Conclusion
3	**Cultural Change and Transformation** Following the cultural impact of the Grenfell fire, the ongoing evolution of the pre-existing Tri-Borough arrangement and the wider circumstances in which you are now operating as an organisation, you acknowledge that change and transformation within the Council will be required to meet the future financial and operational challenges which you face. We will review your plans for implementing cultural change and arrangements for designing, implementing and monitoring any specific programmes for embedding your strategic objectives through transformation and change.	Given the other changes you are also facing such as the gradual move away from the previous Tri-Borough arrangement, including implementation of the new finance and IT systems, and the necessary changes in operational style arising from the financial pressures faced, ensuring leadership capacity to effectively manage and oversee major change programmes and ensure that progress towards your strategic aims is made is a key consideration. **Conclusion** It is evident that you have carefully considered how to reinvigorate your organisation to modernise and become forward looking. The timeframes are ambitious and, in respect of the cultural change element, unlikely to be realised completely within a short period of time. Early thinking is promising, but many of the detailed arrangements are yet to be established, and these are essential for supporting an organisation-wide transformation programme. A reliance on external consultants is, to an extent, unavoidable, but care will need to be taken to ensure the Council “owns” the change and feels able to drive its direction and delivery. It will be essential that change becomes embedded and is not reliant on the continued presence of consultants as this dovetails into business as usual, and that anticipated future training is identified at an early stage. A strong vision for the future is essential, to enable a target operating model to be developed within a narrative that engages ‘hearts and minds’ and provides a direction of travel for future transformation programmes to drive efficiencies, new ways of working and cultural change. Of significant risk is the capacity of senior leadership, which will need to be able to devote sufficient, significant time to this agenda whilst at the same time continuing to respond to a variety of uncoordinated matters which continue to arise as a result of the Grenfell Tower fire. It is important to start setting out the future of the organisation, as this will be essential in driving embedded change owned across the Council, whilst continuing to respond to the existing challenges. Clearly identified and articulated benefits, set out in well documented business cases, with early articulation of the ‘story to be told’ are essential if the anticipated benefits are to be realised and expenditure on transformation to be deployed efficiently and productively. A thorough understanding of the critical path analysis and interdependencies will also be key to minimise the impact of slippage and enable effective prioritisation of delivery. Transparent and effective oversight at the appropriate level, which is neither stifling to on-the-ground innovation, engagement and ownership, nor too remote to identify early problems, will be key. We will continue to review progress as you develop your early stage arrangements.

Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Financial Reporting Council's Ethical Standard and confirm that we, as a firm, and each covered person, are independent and are able to express an objective opinion on the financial statements

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in December 2017 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

Details of fees charged are detailed in Appendix D

Audit and Non-audit services

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to you. The following non-audit services were identified which were chargeable from the beginning of the financial year to 12 September 2019, as well as the threats to our independence and safeguards that have been applied to mitigate these threats. All identified non-audit services relate to the Royal Borough of Kensington and Chelsea. No non audit services were identified in respect of Kensington and Chelsea Pension Fund.

	Fees £	Threats identified	Safeguards
Audit related			
Housing Benefit subsidy claim certification	12,000	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work is low in comparison to the total fee for the audit of £93,497 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors all mitigate the perceived self-interest threat to an acceptable level.
Certification of Housing Capital Receipts Grant	2,000	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work low in comparison to the total fee for the audit of £93,497 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors all mitigate the perceived self-interest threat to an acceptable level.
Teachers' Pension return certification	5,000	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work is low in comparison to the total fee for the audit of £93,497 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors all mitigate the perceived self-interest threat to an acceptable level.
GLA Grant Compliance checklist	3,000	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work is low in comparison to the total fee for the audit of £93,497 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors all mitigate the perceived self-interest threat to an acceptable level.

Independence and ethics

Non-audit related			
Place Analytics – CFO Insights Subscription	12,500	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this subscription is low in comparison to the total fee for the audit of £93,497 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors mitigate the perceived self-interest threat to an acceptable level.

These services are consistent with your policy on the allotment of non-audit work to your auditors. All services have been approved by the Audit and Transparency Committee. None of the services provided are subject to contingent fees.

Action plan

Controls
- High – Significant effect on control system
- Medium – Effect on control system
- Low – Best practice

We have identified three recommendations for you as a result of issues identified during the course of our audit. We have agreed our recommendations with management and we will report on progress on these recommendations during the course of the 2019/20 audit. The matters reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with auditing standards.

	Assessment	Issue and risk	Recommendations
1	Medium	**Adequacy of support for key accounting estimates** During our audit it was identified that many of the key accounting estimates in the financial statements, such as expected credit loss allowances and provision for business rates appeals, were calculated based on anecdotal evidence or percentages which had been applied in previous years. These inputs could not be supported with robust evidence or documentation and as such alternative additional audit procedures were required to gain assurance that the associated accounts balances were not materially misstated. It is important for management to ensure that estimates and judgements are based on relevant and up to date information so that management has assurance over the material accuracy of their financial statements.	We recommend that management revisit each of the key accounting estimates in the financial statements and ensure that they are able to support the most significant inputs and assumptions into the calculation of such estimates with appropriate evidence and documentation. **Management response** The Council has plans to review, during the latter part of 2019, all areas where significant estimates are used. As part of this review we will work with external audit to ensure all audit working papers meet their requirements and ensure service finance teams are guided to provide good quality supporting documentation. Over the past 12 months, the Council has moved from a devolved finance function to a centralised one. During this process, a clear training need in financial accounting and reporting across local finance teams that have been brought into the corporate centre has been identified. A training plan will be developed starting from this autumn to address some of these skills gaps in advance of next year's audit. Specific guidance on appropriate use of estimation techniques and justifying rationale behind calculations will be included in this training programme. Production of good quality working papers and maintenance of third-party documentation will also be covered.

Action plan

Controls
- High – Significant effect on control system
- Medium – Effect on control system
- Low – Best practice

	Assessment	Issue and risk	Recommendations
2	Medium	**Effectiveness of processes and procedures in place with departments outside of corporate finance** During the audit, significant difficulties and delays were encountered with obtaining supporting documentation for account balances or sampled items, where the source of this information was outside of the corporate finance team. In particular, documentation provided from the property team and the subsidiary organisation, Repairs Direct Ltd, was frequently delayed or insufficient.	Management should establish effective and efficient processes for provision of audit evidence across the organisation. **Management response** Following control of Repairs Direct Ltd transferring to the Council in 2018, several key officers in Finance left the TMO. This impacted the ability of the Council's Housing Finance team to provide certain information. A recruitment campaign in now underway to appoint staff so that the team is fully resourced going forward. We will work closely with Property to improve understanding around adequacy of supporting documentation and the need to maintain this in-year to minimise the impact during external audits. Collective ownership and responsibility for closure of accounts and audit is being continually promoted. A standardised suite of templates and working papers is being developed for use next year to ensure consistency in quality of documentation and improve understanding of how local work fits into financial reporting. E-Learning modules will be developed as mandatory training and other workshops are being designed to cover key financial accounting fundamentals. The action plan set out under recommendation 1 above will also address this recommendation.
3	Medium	**Controls around payment of employee expenses** During our walkthrough of the processes and controls in place in relation to payroll expenditure, we identified that your HR team no longer have any access to or control over payroll processes, following the implementation of the new shared service arrangement with Hampshire County Council. In particular, employee expenses do not require approval and in one instance, this led to one employee erroneously receiving an allowance of £2,000 per month to which they had not been entitled. This was identified through a quarterly monitoring process and subsequently corrected, however there remains a risk that inadequate control of payroll expenditure could lead to inaccurate reporting of financial information.	Management should ensure that despite now being involved in the shared service arrangement with Hampshire County Council, they retain sufficient oversight for the control processes in place. **Management response** The process as described is the agreed way of working under the Hampshire partnership which is a high trust model. The routine compliance checks are the agreed control for this process and this instance being picked up and corrected evidences that the controls work. These consist of random selections of expenses claimed whereby managers are required to review and validate receipts and claim.

Action plan (continued)

Controls
- High – Significant effect on control system
- Medium – Effect on control system
- Low – Best practice

The following four recommendations arose from our review of your IT General Control environment:

	Assessment	Issue and risk	Recommendations
1	Medium	**No formal process to notify security administration of employee terminations** We were informed that there was no formal process to notify CIVICA system administrators of employee terminations and work status changes that impact access rights. In mitigation, the systems administrators rely on the process of user account review they perform regularly to identify dormant accounts and any inappropriate access granted and they disable access after the exercise. If there are no formal procedures and clear responsibilities established for handling notifying Security Administration Function on leavers, there is a risk that access to the system will not be disabled timeously resulting in ex-users who have left or transferred continuing to have access to the systems.	We recommend that HR should send automatic notifications to Security Administrators upon employee termination. This will help ensure that staff are removed promptly from the system. Alternatively, HR may compile list of monthly leavers and share it proactively with all system security administrators for action. **Management response** Retained HR are currently exploring with our outsourced HR providers, Hampshire County Council, how a range of reports (including a leavers report) can be obtained via the SAP system. As soon as this is clarified, retained HR will liaise with the Council's ICT Security Administrators as to how best this recommendation can be met.
2	Medium	**Insufficient details from SOC report to demonstrate that the controls are designed adequately for SAP** We were provided with an ISAE 3402 SOC Type II by Hampshire County Council (HCC) for the RBKC's hosted SAP system. We noted that there were insufficient details to demonstrate that the controls listed below were designed adequately: • Duties of security personnel do not include programming or IT management • User ids required to be unique • Passwords are encrypted • Unauthorised access attempts are logged, investigated and follow-up actions documented. There is a risk that management will not have complete assurance over the design adequacy of controls.	We recommend that management confirm the arrangements that HCC have implemented on behalf of RBKC with respect to the following controls to ensure that: ➢ Duties of security personnel do not include programming or IT management. ➢ User ids are unique. ➢ Passwords are encrypted. ➢ Unauthorised access attempts are logged, investigated and follow-up actions documented. **Management response** The Council takes assurance from the ISAE 3402 control environment report issued by Hampshire's external auditor. Further information has been requested from Hampshire to specifically address the areas mentioned in this report so that these can be documented in support of the ISAE 3402 assurances.

Action plan (continued)

Controls
- High – Significant effect on control system
- Medium – Effect on control system
- Low – Best practice

	Assessment	Issue and risk	Recommendations
3	Medium	**SAP Password Controls** Currently, the SAP password policy for external users requires a length of 7 characters that do not need to be changed. With regards to this last point, this chimes with HMG National Cyber Security Centre (NCSC) advice which has stated that changing a password regularly can encourage poor password practices such as simply adding numbers to old and common passwords. Instead NCSC do encourage longer passwords that can be based upon a memorable phrase with a mix of characters, numbers and special characters. For example, the NCSC quote '3redhousemonkeys27!' on their website to illustrate this approach. This password is 19 characters long and uses complex characters. Weak password controls could give rise to compromise of accounts through password guessing or cracking.	We recommend that management review the adequacy of the current password criteria regarding length in light of NCSC advice to strengthen those passwords that are not changed by business users. **Management response** Corporate IT have recently established an Information Security Forum as a standing agenda item as part of the quarterly bi-Borough Strategy board; The main aim is to review opportunities for improvement and to track the effectiveness of the business-as-usual security activities. The IS Forum will provide leadership and direction to Security Working Groups including review and agreement of the Security Improvement Plan (SIP). The SIP will include reference to the NCSC's recent guidance covering password policy for review at a future ISF (date tbc – within 3 months). Corporate IT's approach will be primarily focussed on Active Directory however systems identified where data can be classified OFFICIAL-SENSITIVE (Adults, Children's, Grenfell) will also be evaluated.
4	Medium	**Information Security (IS) related policies and procedures** We were provided with an IS Policy Statement and Personnel Commitment Statement. Both were at draft status and appeared incomplete. Incomplete security administration processes that are not formalized, may not be understood by, or communicated to those within the organization responsible for observing and/or implementing them.	We recommend that management ensure that all IS related policies and procedures should be formalised and distributed. **Management response** Corporate IT have recently established an Information Security Forum as a standing agenda item as part of the quarterly bi-Borough Strategy board; The main aim is to review opportunities for improvement and to track the effectiveness of the business-as-usual security activities. The IS Forum will provide leadership and direction to Security Working Groups including accountability for approving Security Policy documents. The following Security policies are planned for review at the next ISF (date tbc – within 3 months): • Information Security Policy; • Acceptable Use Policy; • Information Security User Guidelines; • Email and Internet Policy; • Incident Management; • Information Handling Policy; • IS Governance Policy;

Audit Adjustments – Royal Borough of Kensington and Chelsea

We are required to report all non trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management.

Impact of adjusted misstatements

All adjusted misstatements are set out in detail below along with the impact on the key statements and the reported net expenditure for the year ending 31 March 2019.

	Detail	CIES £'000	Balance Sheet £'000	Impact on total net expenditure £'000
1	**Impact of the McCloud pensions ruling** Management requested estimates from their actuary of the potential impact of the McCloud ruling. The actuary's estimate for the was of a possible increase in past service cost and overall pension liabilities of £8,259k. Management have chosen to update their financial statements to reflect the revised estimate of the total liabilities. This has resulted in changes to the draft Chief Constable, PCC and Group Comprehensive Income and Expenditure Statements, Balance Sheets and Movement in Reserves Statements, as well as a number of the Notes to the financial statements including the Expenditure and Funding Analysis and explanatory note, Adjustments between Accounting Basis and Funding Basis under Regulation, Unusable Reserves and Defined Benefit Pension Schemes.	8,259	(8,259)	8,259
2	**Grant income receivable at year-end** Management accrued for capital grant income receivable from MHCLG in respect of the Grenfell fire recovery on the basis of estimated costs at the time of the grant claim submission. The amount paid over was £2,703k higher than the amount estimated. This has resulted in an adjustment to long-term debtors in the balance sheet, with a corresponding adjustment to capital grants receipts in advance. This has also impacted upon the cash flow statement, with an adjustment between operating and investing activities, and the associated disclosure notes.	0	2,703	0
	Overall impact	£8,259	£5,556	£8,259

Audit Adjustments – Royal Borough of Kensington and Chelsea

Misclassification and disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

Disclosure error/omission	Detail	Adjusted?
Events after the reporting period – transfer of the Grenfell Tower site to MHCLG	During the course of our audit, it came to our attention that the agreed transfer of ownership the Grenfell Tower site to MHCLG was likely to complete prior to the approval of the financial statements and the issue of our auditor's report. This completed on 15 July 2019, and as such management have included a non-adjusting event after the reporting period within the disclosure notes to the financial statements.	✓
Impact of the McCloud pensions ruling	In addition to the impact of the increased past service cost and net pension liability arising from the McCloud judgement on the core financial statements as outlined under 'adjusted misstatements' above, amendments of £8,259k were also required to various disclosure notes to the financial statements, including Adjustments between Accounting Basis and Funding Basis under Regulation, Expenditure and Funding Analysis, Note to the Expenditure and Funding Analysis, Unusable Reserves and Defined Benefit Pension Schemes.	✓
Grenfell capital grant income	We identified that £12,081k of grant income received from MHCLG in respect of the Grenfell fire recovery was misclassified as revenue whereas it was allocated for capital purposes. The adjustment of this error also impacted on the notes to the Cash Flow Statement.	✓
Housing Revenue Account – vacant possession of dwellings	We noted in our review that this disclosure was incorrectly stated by £38,768k in the notes to the HRA. This has been amended in the updated draft of the financial statements and does not impact upon the balance sheet.	✓
Prior year comparators in the Housing Revenue Account Income and Expenditure Statement	We noted that the lines for 'Repairs and Maintenance' and 'Supervision and Management' in the prior year comparative figures disclosed in the Housing Revenue Account Income and Expenditure Statement did not agree to the audited 2017/18 financial statements. This was a mapping error in compiling the draft 2018/19 financial statements, which was amended in the final draft, which resulted in an decrease of £1,712k to the 'Repairs and Maintenance' line and a corresponding increase in the 'Supervision and Management' line.	✓
Leases disclosure – future minimum operating lease payments receivable	During our testing we identified that income in respect of one leased property, which was split into numerous leasable units, had been included in the disclosure of future minimum lease payments receivable for the next five years, where lease agreements were only in place for one year and in some instances no agreement was in place beyond 2018/19. This led to a reduction in total future lease income receivable of £1,270k which was split across the 'Not later than one year' and 'Later than one year and not later than five years' lines in the disclosure note.	✓
NDR Appeal provision disclosure	In the provisions disclosure note, the split between 'Additional provisions made' and 'Amounts used' in respect of the NDR Appeals provision was incorrect in the draft financial statements. This was adjusted for in the updated draft of the financial statements, which led to an increase of £3,118k in both lines, with a net impact of nil.	✓
Defined benefit pension schemes disclosure	Whilst agreeing the disclosure note to the actuarial reports, we identified that the signage of figures relating to the remeasurement of the net defined benefit liability were erroneously reversed. This was amended in the updated draft of the financial statements, resulting in a movement of £191,830k in the total post employment benefits charged to the CIES, split over a number of the remeasurement lines. The balance sheet figures were correct and this affected the disclosure note only.	✓

Audit Adjustments – Royal Borough of Kensington and Chelsea

Misclassification and disclosure changes (continued)

Disclosure error/omission	Detail	Adjusted?
Financial Instruments disclosure note – financial assets disclosure	We identified that the expected credit loss allowance relating to Collection Fund debtors had been included within the breakdown of 'financial assets carried at amortised cost' within the Financial Instruments disclosure note. Collection Fund debt arises under statute rather than contract, meaning that this does not meet the definition of a Financial Instrument under IFRS 9 and the CIPFA Code. The associated debtors had already been correctly excluded from the financial assets disclosure. The expected credit loss allowance was removed in the final draft of the financial statements, which increased the financial assets figure by £9,225k with a corresponding decrease to the non-financial assets subtotal.	✓
Financial Instruments disclosure note – non-financial assets subtotal	The non-financial assets subtotal in the draft Financial Instruments disclosure note was updated to correctly reconcile the total of financial and non-financial assets to the balance sheet. The impact of this change was £30,212k.	✓
PPE reclassifications – transfer of Marlborough Primary School	Included within transfers occurring in-year between Assets Under Construction and Other Land and Buildings was Marlborough Primary School, which was transferred at a value of £39,615k. It transpired that the School had become operational in September 2017 and as such the transfer should have been included in the 2017/18 financial statements. This was updated in the final draft of the financial statements and the prior period figures were restated. A prior period adjustment note was added to the financial statements since the values involved were material.	✓
PPE reclassifications – accounting treatment	It was identified that management had accounted incorrectly for the transfer of properties from Assets Under Construction into Dwellings upon completion. The required amendments were £15,404k of enhancements being moved into Assets Under Construction and out of Dwellings. Similar issues were identified in respect of investment properties, with £6,129k of enhancements moved from Dwellings into Investment Properties. Adjustments were also required to the Revaluation Reserve and CIES, as reclassified assets were accounted through the Revaluation Reserve rather than through 'Other movements'. The adjustment was £26,025k.	✓
A number of other minor presentational and narrative changes were made to the final draft of the financial statements as a result of our audit procedures.		

Audit Adjustments – Royal Borough of Kensington and Chelsea

Impact of unadjusted misstatements

At the time of writing, no non-trivial misstatements have been identified through our audit work which have not been adjusted for by management. This position will be updated to the date of issuing our auditor's report.

	Detail	CIES £'000	Balance Sheet £'000	Impact on total net expenditure £'000	Reason for not adjusting
1	**Investment Properties** It was noted during our comparison of the valuation report for Investment Properties provided by the external valuation specialist to the Fixed Asset Register that a number of properties had been double-counted in the financial statements. This overstates the value of Investment Properties in the balance sheet and the movement in the fair value of Investment Properties in the CIES.	(4,493)	(4,493)	(4,493)	Management consider the error to be immaterial. This will be adjusted for during 2019/20.
2	**Capital additions** Management were unable to provide supporting evidence for one item of capital expenditure in our sample. This expenditure was incurred with the subsidiary company, Repairs Direct Limited, which ceased to operate from April 2019 and as such the members of staff responsible for maintaining the supporting evidence had since left the Council. The value of the potentially erroneous sample item was £210k, with the extrapolated impact across the population of capital expenditure being £1,572k.		(1,572)		Management do not consider this to be an error as the capital expenditure is valid. Management are looking to improve the processes and controls in place around adequacy of supporting evidence retained from teams outside of central finance.
3	**Grant income** In our sample of taxation and non-specific grant income, we noted one grant relating to Adult Social Care which had been received in 2009/10 with no conditions attached, and incorrectly deferred on the balance sheet in each ensuing year. Management had identified this error and written out the deferred grant income to the CIES in 2018/19. The classification of the income was also incorrect due to this being related to a service rather than non-specific income. The impact was to understate grant income in 2009/10 and overstate grant income in 2018/19.	(3,276)		(3,276)	Management consider the error to be immaterial, hence have not undertaken a prior period adjustment and restated their prior period balance sheets from 2009/10 onwards to amend for this error. Since the income has been written out to the CIES in 2018/19, this will not impact upon the financial statements in future years.
	Overall impact	**(£7,769)**	**(£6,065)**	**(£7,769)**	

Impact of prior year unadjusted misstatements

No non-trivial unadjusted misstatements were identified within the prior year financial statements, as per the prior year ISA 260 report from the predecessor auditors.

Audit Adjustments – Kensington and Chelsea Pension Fund

We are required to report all non trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management.

Impact of adjusted and unadjusted misstatements

At the time of writing, no non-trivial misstatements have been identified through our audit work. This position will be updated to the date of issuing our auditor's report.

Misclassification and disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which management has agreed to amend in the final set of financial statements.

Disclosure omission	Detail	Adjustment made?
Impact of the McCloud pensions ruling	In light of the McCloud pensions ruling, management requested their actuary to prepare updated estimates of the valuation of promised retirement benefits as at 31 March 2019, as required for disclosure in the notes to the Pension Fund Financial Statements under IAS 26. Management's actuary (Barnett Waddingham), estimated an increase in liabilities to be disclosed of £9.2m. We have reviewed the analysis performed by the actuary, and consider that the approach that has been taken to arrive at this estimate is reasonable. Management have therefore updated their IAS 26 disclosure to reflect this increased liability in the final draft of the financial statements.	✓
Movements in Investments disclosure	Through our testing, we noted that purchases and sales for pooled investments in the 'Movements in Investments' disclosure note were both overstated by £249m. There was no impact on the net movement on investments in the Net Assets Statement. This has been amended in the final draft of the financial statements.	✓
Critical judgements	The critical judgments disclosed in Note 5 all relate to areas of estimation uncertainty. We would expect judgements around estimation uncertainty to be disclosed within Note 4, and only significant judgements unrelated to estimates to be disclosed in Note 5. The financial statements include a cross-reference but were not updated.	X
Fair value disclosures in relation to level 2 and 3 investments	Additional disclosures were included in Note 16 to explain the valuation basis, key observable and unobservable inputs and key sensitivities underpinning the fair value calculations of each class of investment asset. An additional table was also added to Note 16 to assess the potential movements in valuation of level 3 investments which would arise from fluctuations in the significant unobservable inputs into the valuation process.	✓

A number of other minor presentational and narrative changes were made to the final draft of the Pension Fund financial statements as a result of our audit procedures.

Impact of prior year unadjusted misstatements

No unadjusted misstatements were identified within the prior year financial statements, as per the prior year ISA 260 report from the predecessor auditors.

Fees

We confirm below our final fees charged for the audit and provision of non-audit services.

Audit Fees

	Proposed fee (£)	Final fee (£)
Council Audit	93,497	113,297
Pension Fund Audit	16,170	16,170
Audit of subsidiary company Repairs Direct Limited	15,000	TBC
Total audit fees (excluding VAT)	**£124,667**	**£TBC**

- The audit of Repairs Direct Limited is scheduled to take place from August 2019, therefore final fees will be confirmed once this has been completed.
- The fees stated above reconcile to the financial statements, with the exception of the audit of Repairs Direct Limited which is not disclosed in the financial statements as this relates to a separate statutory audit.

Non Audit Fees

Fees for other services	Fees (£) – TBC
Audit related services:	
• Housing Benefit subsidy claim certification	12,000
• Teachers' Pension return certification	5,000
• Pooling Housing Capital Receipts grant claim certification	2,000
• GLA Grant compliance checklist	3,000
Non-audit services:	
• Place Analytics – CFO Insights subscription	12,500
	£TBC

- All non-audit fees stated above relate to the Royal Borough of Kensington and Chelsea. No non-audit fees were identified for Kensington and Chelsea Pension Fund
- All fees listed under 'Audit related services' have been provisionally agreed but the work is due to be undertaken later in 2019. No bills have yet been raised in respect of this work.
- Fees payable in respect of Housing Benefit subsidy claim certification are subject to change dependent on the level of errors identified within the initial testing.
- The fees stated above reconcile to the financial statements.

Audit opinion – Royal Borough of Kensington and Chelsea

We anticipate we will provide Royal Borough of Kensington and Chelsea with an unmodified audit report

Independent auditor's report to the members of the Royal Borough of Kensington and Chelsea

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of the Royal Borough of Kensington and Chelsea (the 'Authority') for the year ended 31 March 2019 which comprise the Comprehensive Income and Expenditure Statement, the Movement in Reserves Statement, the Balance Sheet, the Cash Flow Statement, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement, the Collection Fund Statement and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2018/19.

In our opinion, the financial statements:

- give a true and fair view of the financial position of the Authority as at 31 March 2019 and of its expenditure and income for the year then ended;
- have been prepared properly in accordance with the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2018/19; and
- have been prepared in accordance with the requirements of the Local Audit and Accountability Act 2014.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the 'Auditor's responsibilities for the audit of the financial statements' section of our report. We are independent of the Authority in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Executive Director of Resources and Assets' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Executive Director of Resources and Assets has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Authority's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Other information

The Executive Director of Resources and Assets is responsible for the other information. The other information comprises the information included in the Statement of Accounts, the Narrative Report and the Annual Governance Statement, other than the financial statements, our auditor's report thereon and our auditor's report on the pension fund financial statements. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge of the Authority obtained in the audit or otherwise appears to be materially misstated. If we identify such material

Audit opinion – Royal Borough of Kensington and Chelsea

inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Other information we are required to report on by exception under the Code of Audit Practice

Under the Code of Audit Practice published by the National Audit Office on behalf of the Comptroller and Auditor General (the Code of Audit Practice) we are required to consider whether the Annual Governance Statement does not comply with the 'Delivering Good Governance in Local Government: Framework (2016)' published by CIPFA and SOLACE or is misleading or inconsistent with the information of which we are aware from our audit. We are not required to consider whether the Annual Governance Statement addresses all risks and controls or that risks are satisfactorily addressed by internal controls.

We have nothing to report in this regard.

Opinion on other matter required by the Code of Audit Practice

In our opinion, based on the work undertaken in the course of the audit of the financial statements and our knowledge of the Authority gained through our work in relation to the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources, the other information published together with the financial statements in the Statement of Accounts, the Narrative Report and the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

Under the Code of Audit Practice, we are required to report to you if:

- we issue a report in the public interest under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or

- we make a written recommendation to the Authority under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or

- we make an application to the court for a declaration that an item of account is contrary to law under Section 28 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or;

- we issue an advisory notice under Section 29 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or

- we make an application for judicial review under Section 31 of the Local Audit and Accountability Act 2014, in the course of, or at the conclusion of the audit.

We have nothing to report in respect of the above matters.

Responsibilities of the Authority, the Executive Director of Resources and Assets and Those Charged with Governance for the financial statements

As explained more fully in the Statement of Responsibilities set out on page 21, the Authority is required to make arrangements for the proper administration of its financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In this authority, that officer is the Executive Director of Resources and Assets. The Executive Director of Resources and Assets is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2018/19, for being satisfied that they give a true and fair view, and for such internal control as the Executive Director of Resources and Assets determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Executive Director of Resources and Assets is responsible for assessing the Authority's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless there is an intention by government that the services provided by the Authority will no longer be provided.

The Audit and Transparency Committee is Those Charged with Governance. Those charged with governance are responsible for overseeing the Authority's financial

Audit opinion – Royal Borough of Kensington and Chelsea

reporting process.

Auditor's responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Report on other legal and regulatory requirements - Delay in certification of completion of the audit

We are required to give an opinion on the consistency of the pension fund financial statements of the Authority included in the Pension Fund Annual Report with the pension fund financial statements included in the Statement of Accounts. The Local Government Pension Scheme Regulations 2013 require authorities to publish the Pension Fund Annual Report by 1 December 2019. As the Authority has not prepared the Pension Fund Annual Report at the time of this report we have yet to issue our report on the consistency of the pension fund financial statements. Until we have done so, we are unable to certify that we have completed the audit of the financial statements in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice.

AND

We cannot formally conclude the audit and issue an audit certificate until we have completed the work necessary to give a conclusion on the Authority's arrangements for securing value for money through economic, efficient and effective use of its resources for the year ended 31 March 2019. We are unable to issue our conclusion until we have completed our consideration of matters arising to assess their impact on the value for money of service delivery. We are satisfied that these matters do not have a material effect on the financial statements.

Use of our report
This report is made solely to the members of the Authority, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014 and as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. Our audit work has been undertaken so that we might state to the Authority's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's members as a body, for our audit work, for this report, or for the opinions we have formed.

[Signature]

Paul Grady
for and on behalf of Grant Thornton UK LLP, Local Auditor

London

Audit opinion – Kensington and Chelsea Pension Fund

We anticipate we will provide Kensington and Chelsea Pension Fund with an unmodified audit report

Independent auditor's report to the members of the Royal Borough of Kensington and Chelsea on the pension fund financial statements of Kensington and Chelsea Pension Fund

Opinion

We have audited the financial statements of Kensington and Chelsea Pension Fund (the 'pension fund') administered by the Royal Borough of Kensington and Chelsea (the 'Authority') for the year ended 31 March 2019 which comprise the Fund Account, the Net Assets Statement and notes to the pension fund financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2018/19.

In our opinion, the financial statements:

- give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2019 and of the amount and disposition at that date of the fund's assets and liabilities;
- have been prepared properly in accordance with the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2018/19; and
- have been prepared in accordance with the requirements of the Local Audit and Accountability Act 2014.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the 'Auditor's responsibilities for the audit of the financial statements' section of our report. We are independent of the Authority in accordance with the ethical requirements that are relevant to our audit of the pension fund's financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Executive Director of Resources and Assets' use of the going concern basis of accounting in the preparation of the pension fund's financial statements is not appropriate; or
- the Executive Director of Resources and Assets has not disclosed in the pension fund's financial statements any identified material uncertainties that may cast significant doubt about the Authority's ability to continue to adopt the going concern basis of accounting for the pension fund for a period of at least twelve months from the date when the pension fund's financial statements are authorised for issue.

Other information

The Executive Director of Resources and Assets is responsible for the other information. The other information comprises the information included in the Statement of Accounts, the Narrative Report and the Annual Governance Statement, other than the pension fund's financial statements, our auditor's report thereon and our auditor's report on the Authority's financial statements. Our opinion on the pension fund's financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the pension fund's financial statements, our

Audit opinion – Kensington and Chelsea Pension Fund

responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the pension fund's financial statements or our knowledge of the pension fund obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the pension fund's financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Opinion on other matter required by the Code of Audit Practice published by the National Audit Office on behalf of the Comptroller and Auditor General (the Code of Audit Practice)
In our opinion, based on the work undertaken in the course of the audit of the pension fund's financial statements and our knowledge of the pension fund the other information published together with the pension fund's financial statements in the Statement of Accounts, the Narrative Report and the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the pension fund's financial statements.

Matters on which we are required to report by exception
Under the Code of Audit Practice, we are required to report to you if:

- we issue a report in the public interest under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or

- we make a written recommendation to the Authority under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or

- we make an application to the court for a declaration that an item of account is contrary to law under Section 28 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or;

- we issue an advisory notice under Section 29 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or

- we make an application for judicial review under Section 31 of the Local Audit and Accountability Act 2014, in the course of, or at the conclusion of the audit.

We have nothing to report in respect of the above matters.

Responsibilities of the Authority, the Executive Director of Resources and Assets and Those Charged with Governance for the financial statements
As explained more fully in the Statement of Responsibilities set out on page 21, the Authority is required to make arrangements for the proper administration of its financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In this authority, that officer is the Executive Director of Resources and Assets. The Executive Director of Resources and Assets is responsible for the preparation of the Statement of Accounts, which includes the pension fund's financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2018/19, for being satisfied that they give a true and fair view, and for such internal control as the Executive Director of Resources and Assets determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the pension fund's financial statements, the Executive Director of Resources and Assets is responsible for assessing the pension fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless there is an intention by government that the services provided by the pension fund will no longer be provided.

The Audit and Transparency Committee is Those Charged with Governance. Those charged with governance are responsible for overseeing the Authority's financial reporting process.

Auditor's responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the pension fund's financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists.

Audit opinion – Kensington and Chelsea Pension Fund

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report
This report is made solely to the members of the Authority, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014 and as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. Our audit work has been undertaken so that we might state to the Authority's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's members as a body, for our audit work, for this report, or for the opinions we have formed.

[Signature]

Paul Grady
for and on behalf of Grant Thornton UK LLP, Local Auditor
London

[Date]

Management Letter of Representation – Royal Borough of Kensington and Chelsea

Grant Thornton UK LLP
110 Bishopsgate
LONDON
EC2N 4AY

12 September 2019

Dear Sirs
Royal Borough of Kensington and Chelsea

Financial Statements for the year ended 31 March 2019

This representation letter is provided in connection with the audit of the financial statements of the Royal Borough of Kensington and Chelsea for the year ended 31 March 2019 for the purpose of expressing an opinion as to whether the Council financial statements are presented fairly, in all material respects in accordance with International Financial Reporting Standards and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 and applicable law.

We confirm that to the best of our knowledge and belief having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

Financial Statements

i. We have fulfilled our responsibilities for the preparation of the Council's financial statements in accordance with International Financial Reporting Standards and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 ("the Code"); in particular the financial statements are fairly presented in accordance therewith.

ii. We have complied with the requirements of all statutory directions affecting the Council and these matters have been appropriately reflected and disclosed in the financial statements.

iii. The Council has complied with all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance. There has been no non-compliance with requirements of any regulatory authorities that could have a material effect on the financial statements in the event of non-compliance.

iv. We acknowledge our responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.

v. Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable. We are satisfied that the material judgements used in the preparation of the financial statements are soundly based, in accordance with the Code and adequately disclosed in the financial statements. There are no other material judgements that need to be disclosed.

vi. Except as disclosed in the financial statements:
    a. there are no unrecorded liabilities, actual or contingent
    b. none of the assets of the Council has been assigned, pledged or mortgaged
    c. there are no material prior year charges or credits, nor exceptional or non-recurring items requiring separate disclosure.

vii. We confirm that we are satisfied that the actuarial assumptions underlying the valuation of pension scheme assets and liabilities for IAS19 Employee Benefits disclosures are consistent with our knowledge. We confirm that all settlements and curtailments have been identified and properly accounted for. We also confirm that all significant post-employment benefits have been identified and properly accounted for.

viii. Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of International Financial Reporting Standards and the Code.

Management Letter of Representation – Royal Borough of Kensington and Chelsea

ix. All events subsequent to the date of the financial statements and for which International Financial Reporting Standards and the Code require adjustment or disclosure have been adjusted or disclosed.

x. We have considered the adjusted misstatements, and misclassification and disclosures changes schedules included in your Audit Findings Report. The Council financial statements have been amended for these misstatements, misclassifications and disclosure changes and are free of material misstatements, including omissions.

xi. We have considered the unadjusted misstatements schedule included in your Audit Findings Report and attached. We have not adjusted the financial statements for these misstatements brought to our attention as they are either immaterial to the results of the Council and its financial position at the year-end or for the reasons noted on the schedule

xii. Actual or possible litigation and claims, in particular those arising from the Grenfell fire, have been accounted for and disclosed in accordance with the requirements of International Financial Reporting Standards.

xiii. We have no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.

xiv. We believe that the Council's financial statements should be prepared on a going concern basis on the grounds that current and future sources of funding or support will be more than adequate for the Council's needs. We believe that no further disclosures relating to the Council's ability to continue as a going concern need to be made in the financial statements.

Information Provided

xv. We have provided you with:
  a. access to all information of which we are aware that is relevant to the preparation of the Council financial statements such as records, documentation and other matters;
  b. additional information that you have requested from us for the purpose of your audit; and
  c. unrestricted access to persons within the Council from whom you determined it necessary to obtain audit evidence.

xvi. We have communicated to you all deficiencies in internal control of which management is aware.

xvii. All transactions have been recorded in the accounting records and are reflected in the financial statements.

xviii. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

xix. We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the Council and involves:
  a. management;
  b. employees who have significant roles in internal control; or
  c. others where the fraud could have a material effect on the financial statements.

xx. We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the financial statements communicated by employees, former employees, analysts, regulators or others.

xxi. We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.

xxii. We have disclosed to you the identity of the Council's related parties and all the related party relationships and transactions of which we are aware.

xxiii. We have disclosed to you all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.

Management Letter of Representation – Royal Borough of Kensington and Chelsea

Annual Governance Statement

We are satisfied that the Annual Governance Statement (AGS) fairly reflects the Council's risk assurance and governance framework and we confirm that we are not aware of any significant risks that are not disclosed within the AGS.

Narrative Report

xxiv. The disclosures within the Narrative Report fairly reflect our understanding of the Council's financial and operating performance over the period covered by the Council financial statements.

Approval

The approval of this letter of representation was minuted by the Council's Audit and Transparency Committee at its meeting on 12 September 2019.

Yours faithfully

Management Letter of Representation – Kensington and Chelsea Pension Fund

Grant Thornton UK LLP
110 Bishopsgate
LONDON
EC2N 4AY

12 September 2019

Dear Sirs

Kensington and Chelsea Pension Fund

Financial Statements for the year ended 31 March 2019

This representation letter is provided in connection with the audit of the financial statements of Kensington and Chelsea Pension Fund (‘the Fund) for the year ended 31 March 2019 for the purpose of expressing an opinion as to whether the Fund financial statements are presented fairly, in all material respects in accordance with International Financial Reporting Standards and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 and applicable law.

We confirm that to the best of our knowledge and belief having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

Financial Statements

i. We have fulfilled our responsibilities for the preparation of the Fund’s financial statements in accordance with International Financial Reporting Standards and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 ("the Code"); in particular the financial statements are fairly presented in accordance therewith.

ii. We have complied with the requirements of all statutory directions affecting the Fund and these matters have been appropriately reflected and disclosed in the financial statements.

iii. The Fund has complied with all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance. There has been no non-compliance with requirements of any regulatory authorities that could have a material effect on the financial statements in the event of non-compliance.

iv. We acknowledge our responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.

v. We acknowledge our responsibilities for making the accounting estimates included in the financial statements. Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable. Where it was necessary to choose between estimation techniques that comply with the Code, we selected the estimation technique considered to be the most appropriate to the Fund's particular circumstances for the purpose of giving a true and fair view. Those estimates reflect our judgement based on our knowledge and experience about past and current events and are also based on our assumptions about conditions we expect to exist and courses of action we expect to take.

vi. We are satisfied that the material judgements used in the preparation of the financial statements are soundly based, in accordance with the Code and adequately disclosed in the financial statements. There are no other material judgements that need to be disclosed.

vii. Except as disclosed in the financial statements:
   a. there are no unrecorded liabilities, actual or contingent
   b. none of the assets of the Council has been assigned, pledged or mortgaged
   c. there are no material prior year charges or credits, nor exceptional or non-recurring items requiring separate disclosure.

viii. Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of International Financial Reporting Standards and the Code.

Management Letter of Representation – Kensington and Chelsea Pension Fund

xiv. All events subsequent to the date of the financial statements and for which International Financial Reporting Standards and the Code require adjustment or disclosure have been adjusted or disclosed.

xv. We have considered the adjusted misstatements, and misclassification and disclosures changes schedules included in your Audit Findings Report. The financial statements have been amended for these misstatements, misclassifications and disclosure changes and are free of material misstatements, including omissions.

xvi. Actual or possible litigation and claims have been accounted for and disclosed in accordance with the requirements of International Financial Reporting Standards.

xvii. We have no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.

xviii. We believe that the Fund's financial statements should be prepared on a going concern basis on the grounds that current and future sources of funding or support will be more than adequate for the Fund's needs. We believe that no further disclosures relating to the Fund's ability to continue as a going concern need to be made in the financial statements.

Information Provided

xix. We have provided you with:

a. access to all information of which we are aware that is relevant to the preparation of the Fund financial statements such as records, documentation and other matters;

b. additional information that you have requested from us for the purpose of your audit; and

c. unrestricted access to persons within the Fund from whom you determined it necessary to obtain audit evidence.

xx. We have communicated to you all deficiencies in internal control of which management is aware.

xxi. All transactions have been recorded in the accounting records and are reflected in the financial statements.

xxii. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

xxiii. We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the Fund and involves:

a. management;

b. employees who have significant roles in internal control; or

c. others where the fraud could have a material effect on the financial statements.

xxiv. We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the financial statements communicated by employees, former employees, analysts, regulators or others.

xxv. We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.

xxvi. There have been no communications with The Pensions Regulator or other regulatory bodies during the year or subsequently concerning matters of non-compliance with any legal duty.

xxvii. We are not aware of any reports having been made to The Pensions Regulator by any of our advisors.

xxviii. We have disclosed to you the identity of the Fund's related parties and all the related party relationships and transactions of which we are aware.

xxix. We have disclosed to you all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.

Management Letter of Representation – Kensington and Chelsea Pension Fund

Approval
The approval of this letter of representation was minuted by the Council's Audit and Transparency Committee at its meeting on 12 September 2019.

Yours faithfully

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