KPMG

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Report to those charged with governance (ISA 260) 2013/14

Royal Borough of Kensington and Chelsea

22 September 2014

Contents

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled *Statement of Responsibilities of Auditors and Audited Bodies*. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document which is available on the Audit Commission's website at www.auditcommission.gov.uk.

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

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Andy Sayers the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, 3rd Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 0303 4448 330.

Section one

Introduction

This document summarises:

- **the key issues identified during our audit of the financial statements for the year ended 31 March 2014 for both the Authority and its pension fund; and**
- **our assessment of the Authority's arrangements to secure value for money.**

Scope of this report

This report summarises the key findings arising from:

- our audit work at the Royal Borough of Kensington and Chelsea ('the Authority') in relation to the Authority's 2013/14 financial statements and those of the Local Government Pension Scheme it administers ('the Fund'); and
- the work to support our 2013/14 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

Financial statements

Our *External Audit Plan 2013/14*, presented to you in March 2014, set out the four stages of our financial statements audit process.

This report focuses on the second and third stages of the process: control evaluation and substantive procedures. Our on site work for these took place during March 2014 (interim audit) and July 2014 (year end audit).

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

VFM conclusion

Our *External Audit Plan 2013/14* explained our risk-based approach to VFM work, which follows guidance provided by the Audit Commission. We have now completed our work to support our 2013/14 VFM conclusion. This included:

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

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our audit work in relation to the 2013/14 financial statements of the Authority and the Fund.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Acknowledgements

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

Headlines

This table summarises the headline messages for the Authority and the Fund. Sections three and four of this report provide further details on each area.

Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2014. We will also report that the wording of your Annual Governance Statement accords with our understanding. We also anticipate issuing an unqualified audit opinion in relation to the Fund's financial statements, as contained both in the Authority's Statement of Accounts and the Pension Fund Annual Report by 30 September 2014.
Audit adjustments	We are pleased to report that our audit of your financial statements did not identify any material adjustments. The Authority made one non-trivial adjustment which increased both short term debtors and short term creditors by £699k and a small number of presentational adjustments. We have included further details at Appendix 1.
Key financial statements audit risks	We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.
Accounts production and audit process	The Authority has strong processes in place for the production of the draft financial statements and excellent supporting working papers. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales.
Control environment	The Authority's organisational and control environment is effective overall, and we have not identified any significant weaknesses in controls over key financial systems.
Completion	At the date of this report our audit of the financial statements is substantially complete with the exception of our final review procedures and closing procedures. Before we can issue our opinion we require a signed management representation letter, which covers the financial statements of both the Authority and the Fund. We will also need to complete our post balance sheet review procedures, covering the period up until the financial statements are signed. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's and the Fund's financial statements.
VFM conclusion and risk areas	We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2014.

Proposed opinion and audit differences

We have identified no issues in the course of the audit of the Authority's financial statements that are considered to be material.

We anticipate issuing an unqualified audit opinion in relation to the Authority's financial statements by 30 September 2014.

Proposed audit opinion

We anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Audit and Transparency Committee on 22 September 2014.

Audit differences

In accordance with ISA 260 we are required to report uncorrected audit differences to you. We also report any material misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities.

The final materiality level for this year's audit of the Authority's financial statements was set at £13.5 million. Audit differences below £650k are not considered significant. Appendix 2 details the change in materiality from that reported in our *External Audit Plan 2013/14*, presented to you in March 2014.

We did not identify any material misstatements. We identified one significant audit difference as follows:

- £699k adjustment to both short term creditors and short term debtors to reflect the Authority's share of NDR debtors and prepayments.

This has been adjusted in the final version of the financial statements.

The table on the right illustrates the total impact of the audit difference on the Authority's balance sheet as at 31 March 2014. There is no impact on the General Fund.

In addition, we identified a small number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 ('the Code')*. The Authority has addressed these where significant.

Balance Sheet as at 31 March 2014

£000	Pre-audit	Post-audit
Property, plant and equipment	1,266,510	1,266,510
Other long term assets	207,625	207,625
Current assets	314,924	315,623
Current liabilities	(118,832)	(119,531)
Long term liabilities	(368,049)	(368,049)
Net worth	**1,302,178**	**1,302,178**
General Fund	(10,000)	(10,000)
Other usable reserves	(257,311)	(257,311)
Unusable reserves	(1,034,867)	(1,034,867)
Total reserves	**(1,302,178)**	**(1,302,178)**

Proposed opinion and audit differences (continued)

We have identified no issues in the course of the audit of the Fund that are considered to be material.

We anticipate issuing an unqualified audit opinion in relation to the Fund's financial statements, as contained both in the Authority's Statement of Accounts and the Pension Fund Annual Report by 30 September 2014.

The wording of your Annual Governance Statement accords with our understanding.

Pension fund audit

Our audit of the Fund also identified one misstatement. This relates to realised and unrealised movements in market value being transposed in error. This is not considered to be a significant matter.

We anticipate issuing an unqualified audit opinion following approval of the Statement of Accounts by the Audit and Transparency Committee on 22 September 2014.

We identified one minor presentational adjustment required to ensure that the accounts are compliant with the *Code* which has been adjusted.

Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

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

Pension Fund Annual Report

We reviewed the Pension Fund Annual Report to confirm that:

- it complies with the requirements of the Local Government Pension Scheme (Administration) Regulations 2008; and
- the financial and non-financial information it contains is not inconsistent with the financial information contained in the audited financial statements.

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

Key financial statements audit risks and areas of focus

We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.

In our *External Audit Plan 2013/14*, presented to you in February 2014, we identified the key areas of audit focus for the Authority's and the Fund's 2013/14 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

Since our External Audit Plan we have identified, and added, Non-Domestic Rates (NDR) as a significant risk to the Authority as a result of the implementation of the Business Rates Retention Scheme in 2013/14.

The table below sets out our detailed findings for each of the areas of focus and risks that are relevant to the Authority and Pension Fund.

Additionally, we considered the risk of management override of controls, which is a standard risk for all organisations.

Our controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual, did not identify any issues.

Area of Focus	Issue	Findings
National Non-Domestic Rates (NDR)	Due to the introduction of Business Rate Localisation, with effect from 1st April 2013, there were significant changes in the requirements for the disclosure of NDR balances and transactions, as per the CIPFA Code. Furthermore, there were significant variances in the balance sheet and the CIES as a result of the change in accounting treatment. These factors meant that non-domestic rates was reassessed as a significant risk area for the audit and therefore has been included as a key financial statement audit risk for the Authority.	We identified one significant audit difference resulting in a £699k increase to the Authority's short term debtors and creditors to reflect the Authority's share of NDR debtors and prepayments.

Section three

Key financial statements audit risks and areas of focus (continued)

We have worked with officers throughout the year to discuss specific areas of audit focus. The Authority addressed the issues appropriately.

Area of audit focus	Issue	Findings
Property, Plant and Equipment	The Authority has a significant asset base primarily relating to Council dwellings and Investment property. The potential for impairment/valuation changes makes this balance inherently risky due to the high level of judgement and estimation uncertainty. This area of focus affects only the Authority.	We have reviewed management's assessment of property valuations and impairment calculations and the information provided to the valuer by the Authority. Additionally we have compared the assumptions made by your valuer to benchmarks and to the assumptions used in 2012/13 for consistency. We are satisfied that the valuation is materially accurate and the revaluation has been treated in line with the Code.
Cash	Cash has a pervasive impact on the financial statements and provides comfort for other areas of the financial statements. This area of focus affects both the Authority and the Fund.	We have obtained third party confirmations over account balances and reviewed and tested the controls over bank reconciliations. We are satisfied that these controls have operated throughout the year and that the cash figure in the financial statements is materially accurate.
Pension Costs and Liabilities	Pension valuations require a significant level of expertise, judgement and estimation and are therefore more susceptible to error. This is also a very complex accounting area increasing the risk of misstatement. This area of focus affects the Authority.	We have reviewed the information provided to the actuary by the Authority. We have also reviewed the actuarial valuation and considered the disclosure implications. Additionally we have compared the assumptions made by your actuaries to benchmarks and to the assumptions. We did not identify any issues to report.

Key financial statements audit risks and areas of focus (continued)

We have worked with officers throughout the year to discuss specific areas of audit focus. The Authority addressed the issues appropriately.

Area of audit focus	Issue	Findings
	During the year, the Pension Fund underwent a triennial valuation with an effective date of 31 March 2013 in line with the Local Government Pension Scheme (Administration) Regulations 2008. The share of pensions assets and liabilities for each admitted body was determined in detail, and a large volume of data was provided to the actuary to support this triennial valuation. The IAS 19 numbers included in the financial statements for 2013/14 are based on the output of the triennial valuation rolled forward to 31 March 2014. For 2014/15 and 2015/16 the actuary will then roll forward the valuation for accounting purposes based on more limited data. There is a risk that the data provided to the actuary for the valuation exercise was inaccurate and that these inaccuracies affected the actuarial figures in the accounts.	We reviewed the data provided to the actuary and confirmed that it was consistent with underlying records. We did not identify any issues to report.

Accounts production and audit process

The Authority has strong processes in place for the production of the accounts and excellent quality supporting working papers.

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

Accounts production and audit process

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

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority has good financial reporting arrangement in place. We note that the Authority has consistently provided detailed working papers and liaised with us on technical issues at an early date to consider the implications for financial reporting. We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 30 June 2014.
Quality of supporting working papers	Our *Accounts Audit Protocol*, which we issued on 11 February 2014 and discussed with the Corporate Finance Manager, set out our working paper requirements for the audit. The quality of working papers provided met the standards specified in our *Accounts Audit Protocol*.
Response to audit queries	Officers resolved audit queries promptly. The quality and timeliness of officers' responses were of a high standard.
Pension fund audit	The audit of the Fund was completed following the main audit. There are no specific matters to bring to your attention relating to this.

Organisational control environment

Your organisational control environment is effective overall.

Work completed

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would have implications for our audit.

We obtain an understanding of the Authority's overall control environment and determine if appropriate controls have been implemented. We do not complete detailed testing of these controls.

We review the outcome of internal audit's work to influence our assessment of the overall control environment, which is a key factor when determining the external audit strategy.

Key findings

We consider that your organisational controls are effective overall.

Aspect	Assessment
Organisational controls:	
Management's philosophy and operating style	3
Culture of honesty and ethical behaviour	3
Oversight by those charged with governance	3
Risk assessment process	3
Communications	3
Monitoring of controls	3

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

Controls over key financial systems

The controls over the majority of the key financial systems are sound.

Work completed

Where we have determined that this is the most efficient audit approach to take, we test selected controls that address key risks within these systems. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

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

Key findings

The controls over the majority of the key financial systems are sound.

In line with 2012/13 we identified a minor area for further improvement in relation to segregation of duties concerning journal processing. The finance system does not enforce separate authorisation of journals, although the Corporate Finance team do operate separate authorisation for all closing of accounts related journals. The Authority is addressing this issue with the introduction of the new finance system, under the 'Managed Services' project, now expected to be implemented in April 2015.

Financial system	Controls Assessment
Cash	3
Pensions	3
Journals	2

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

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

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

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

Declaration of independence and objectivity

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

In relation to the audit of the financial statements of the Royal Borough of Kensington and Chelsea and the Royal Borough of Kensington and Chelsea Pension Fund for the year ending 31 March 2014, we confirm that there were no relationships between KPMG LLP and the Royal Borough of Kensington and Chelsea and the Royal Borough of Kensington and Chelsea Pension Fund, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 3 in accordance with ISA 260.

Management representations

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

Other matters

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

- significant difficulties encountered during the audit;
- significant matters arising from the audit that were discussed, or subject to correspondence with management;
- other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process; and
- matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. significant deficiencies in internal control; issues relating to fraud, compliance with laws and regulations, subsequent events, non disclosure, related party, public interest reporting, questions/objections, opening balances etc).

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report relating to the audit of the Authority's 2013/14 financial statements.

VFM conclusion

Our VFM conclusion considers how the Authority secures financial resilience and challenges how it secures economy, efficiency and effectiveness.

We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Background

Auditors are required to give their statutory VFM conclusion based on two criteria specified by the Audit Commission. These consider whether the Authority has proper arrangements in place for:

- securing financial resilience: looking at the Authority's financial governance, financial planning and financial control processes; and
- challenging how it secures economy, efficiency and effectiveness: looking at how the Authority is prioritising resources and improving efficiency and productivity.

We follow a risk based approach to target audit effort on the areas of greatest audit risk. We consider the arrangements put in place by the Authority to mitigate these risks and plan our work accordingly.

The key elements of the VFM audit approach are summarised in the diagram below.

Work completed

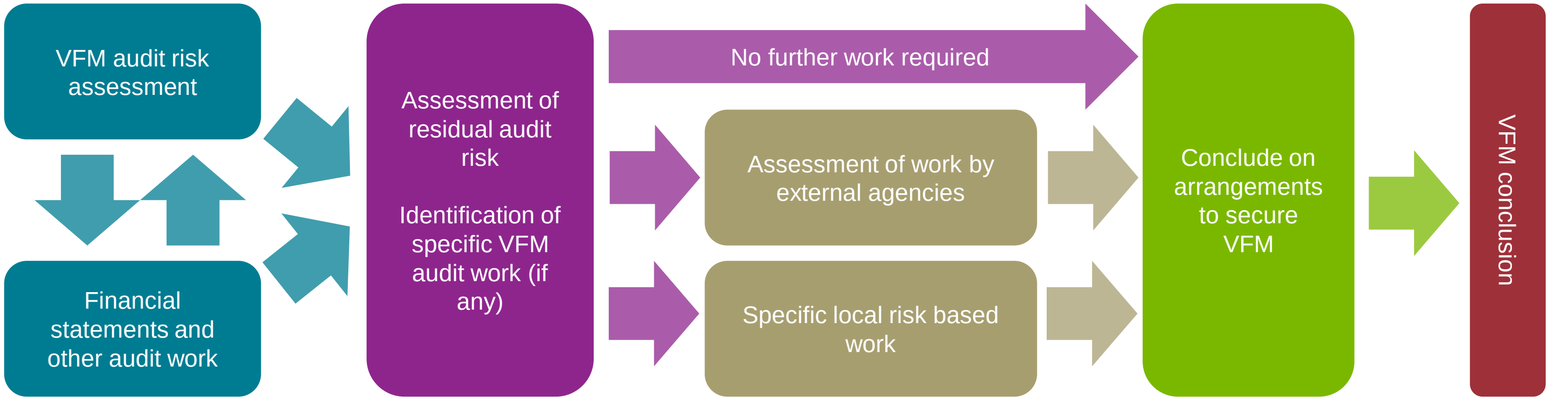
We performed a risk assessment earlier in the year and have reviewed this throughout the year.

We have not identified any significant risks to our VFM conclusion and therefore have not completed any additional work.

Conclusion

We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

VFM criterion	Met
Securing financial resilience	✓
Securing economy, efficiency and effectiveness	✓



Specific VFM risks and areas of audit focus

We did not identify any specific VFM risks.

We have worked with officers throughout the year to discuss specific areas of audit focus. The Authority addressed the issues appropriately.

Work completed

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

- assessed the Authority's key business risks which are relevant to our VFM conclusion; and
- identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit.

Key findings

Our initial risk assessment did not identify any residual risks for our VFM conclusion.

In our *External Audit Plan 2013/14*, presented to you in March 2014, we identified a specific area of focus for our VFM conclusion. The table below sets out our findings in respect of these.

Area of audit focus	Description	Findings
	Based on the current medium term financial plan, which covers the period 2013/14 – 2015/16, there is a significant savings requirement over the three year period. This is on top of the £36m of savings achieved in 2011/12 and 2012/13. The savings required for 2013/14 of £10m have been identified and early indications – including the 2012/13 achievements and under-spends are positive. A further £11m of savings will be required in 2014/15. Many of these savings requirements are due to be delivered via the Tri borough working arrangements. However, finding additional savings year after year will be a challenge. The Authority will need to continue to manage its savings plans to secure longer term financial and operational sustainability and ensure that any related liabilities are accounted for in its 2013/14 financial statements as appropriate.	Our main accounts work has confirmed that the Authority has achieved its £10m savings plans for 2013/14. As part of our Value for Money work we have reviewed the Authority's processes for delivery of its savings plans and consider that robust, achievable plans are in place. The Authority has a current medium term financial plan and detailed annual budget proposals which give due consideration to potential funding reductions. Assumptions in the plan and budget proposals are based on a prudent consideration of the economic climate and the impact on the Council's funding sources.

Appendix 1: Audit differences

This appendix sets out the significant audit differences.

For the Authority audit we are reporting all audit differences over £650k.

These differences have been adjusted in the final version of the financial statements.

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which in your case is the Audit and Transparency Committee). We are also required to report all material misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities. There are no uncorrected misstatements and no material misstatements that have been corrected.

Corrected audit differences – Authority

The following table sets out the significant audit differences identified by our audit of the Royal Borough of Kensington and Chelsea's financial statements for the year ended 31 March 2014.

	Impact					
No.	**Income and Expenditure Statement**	**Movement in Reserves Statement**	**Assets**	**Liabilities**	**Reserves**	**Basis of audit difference**
1			Dr Short Term Debtors £699k	Cr Short Term Liabilities £699k		Adjustment to both short term creditors and short term debtors to reflect the Authority's share of NDR debtors and prepayments. There is no impact on the General Fund.
			Dr £699k	**Cr £699k**		**Total impact of adjustments**

In addition, we identified a small number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 ('the Code')*. The Authority has addressed these where significant.

Corrected audit differences – Fund

We identified one audit difference arising from a transposition error in the Pension Fund Account. This is detailed below and has been corrected.

	Impact		
No.	**Pension Fund Account**	**Net Assets Statement**	**Basis of audit difference**
1	Dr Realised Movements £25,761k Cr Unrealised Movements £25,761k		Realised and unrealised transposed. No impact on the value of the fund.
	-	-	**Total impact of adjustments**

Additionally we identified one presentational matter which the Fund has addressed.

Appendix 2: Materiality and reporting of audit differences

For 2013/14 our materiality is £13.5 million for the Authority's accounts. For the Pension Fund it is £12.7 million.

We have reported all audit differences over £650k for the Authority's accounts and £475k for the Pension Fund to the Audit and Transparency Committee.

Materiality

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

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

In our *External Audit Plan 2013/14*, presented to you in March 2014 we reported our materiality for planning purposes as £20 million equating to approximately 3 percent of gross revenue. In the period leading up to the final accounts audit we reassessed our approach to materiality nationally due to higher risk in the sector as a whole and a number of accounting changes related to pensions and NDR. As a result we reduced materiality for the Authority to £13.5 million. This equates to around 2 percent of gross revenue.

We design our procedures to detect errors in specific accounts at a lower level of precision, set at £650k for 2013/14.

Reporting to the Audit and Transparency Committee

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

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

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

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £650k.

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

Materiality – pension fund audit

The same principles apply in setting materiality for the Pension Fund audit. Materiality for the Pension Fund was set at £12.7 million which is approximately 2 percent of net assets.

We design our procedures to detect errors at a lower level of precision, set at £475k for 2013/14.

Appendix 3: Declaration of independence and objectivity

The *Code of Audit Practice* requires us to exercise our professional judgement and act independently of both the Commission and the Authority.

Requirements

Auditors appointed by the Audit Commission must comply with the *Code of Audit Practice* (the 'Code') which states that:

"Auditors and their staff should exercise their professional judgement and act independently of both the Commission and the audited body. Auditors, or any firm with which an auditor is associated, should not carry out work for an audited body that does not relate directly to the discharge of auditors' functions, if it would impair the auditors' independence or might give rise to a reasonable perception that their independence could be impaired."

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Audit Commission's *Standing Guidance for Local Government Auditors* ('Audit Commission Guidance') and the requirements of APB Ethical Standard 1 *Integrity, Objectivity and Independence* ('Ethical Standards').

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

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

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

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

General procedures to safeguard independence and objectivity

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

Appendix 3: Declaration of independence and objectivity (continued)

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

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

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

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

Auditor declaration

In relation to the audit of the financial statements of the Royal Borough of Kensington and Chelsea and the Royal Borough of Kensington and Chelsea Pension Fund for the financial year ending 31 March 2014, we confirm that there were no relationships between KPMG LLP and the Royal Borough of Kensington and Chelsea and the Royal Borough of Kensington and Chelsea Pension Fund , its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

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