External Audit Report 2015/16

London Borough of Hackney

13 September 2016

Contents

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

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Andrew Sayers, the engagement lead to the Authority and the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, who will try to resolve your complaint. After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3H.

Section one: Introduction

Section one

Introduction

This document summarises:

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

Scope of this report

This report summarises the key findings arising from:

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

Financial statements

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

Planning → Control Evaluation → Substantive Procedures → Completion

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

We are now in the final phase of the audit, the completion stage. Aspects of this stage are referred to in this report.

VFM Conclusion

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

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

Structure of this report

This report is structured as follows:

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

Our recommendations are included in Appendix 1. There are no high priority recommendations.

Acknowledgements

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

KPMG

Section two: Headlines

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 2016. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007. 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 2016.
Audit adjustments	No significant adjustments were identified through our work. There have been a number of narrative adjustments throughout the accounts and accompanying notes. Our audit has identified a small number of presentational adjustments within current assets, current liabilities and Property, Plant and Equipment (PPE). There were also a number of changes to the newly introduced Narrative Report. We have raised a recommendation in relation to the PPE issue highlighted above, which is summarised in Appendix 1.
Key financial statements audit risks	We review risks to the financial statements on an ongoing basis and tailor our audit procedures accordingly. In addition to the rebuttable presumption of the fraud risk from revenue recognition, we identified the following key financial statement audit risks in our 15/16 External audit plan issued in March 2016. — Management override of controls; — Valuation of Property, Plant and Equipment; and — Recognition of Conditional grant income. We have worked with officers throughout the year to discuss these audit risks. Our detailed findings are reported in Section 3 of this report.
Accounts production and audit process	We received complete draft accounts on 2 June 2016, well ahead of the DCLG deadline. We have noted the continued high quality of the accounts and the supporting working papers. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code. As in previous years, we will debrief with the Finance team to share views on the final accounts audit. Hopefully this will lead to further efficiencies in the 2016/17 audit process. In particularly we would like to thank Authority Officers who were available throughout the audit visit to answer our queries.

Headlines (cont.)

VFM conclusion and risk areas	We identified one VFM risk in our External audit plan 2015/16 issued in March 2016. This related to the significant financial challenge in the sector and how the Council mitigates against this through sustainable resource deployment. We have worked with officers throughout the year to discuss this VFM risk and our detailed findings are reported in section 4 of this report. There are no matters of significance arising as result of our audit work in this VFM risk area. We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2016.
Completion	At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas: — Payroll starters, leavers and amendments testing; — VFM – Cost Improvement Plan testing. Information is required for Asset Rationalisation and Property Asset Management; Parking Customer Journey – Channel Shift; Mosaic – integration with the finance system; Supporting People savings programme; and — Review of WGA work. You are required to provide us with representations on specific matters such as your going concern assertion and whether the transactions in the accounts are legal and unaffected by fraud. We provided a draft of this representation letter to the Section 151 Officer on 8 September 2016. We draw your attention to the requirement in our representation letter for you to confirm to us that you have disclosed all relevant related parties to us. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.

Section three: Financial Statements

Proposed opinion and audit differences

We have not identified any issues in the course of the audit which we consider material.

We anticipate issuing an unqualified opinion on the financial statements by 30 September 2016.

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

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 2016.

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Audit Committee on 21 September 2016.

Audit differences

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

The materiality (see Appendix 3 for more information on materiality) level for this year's audit was set at £15 million. Audit differences below £1 million are not considered significant.

We did not identify any significant adjustments. We identified a number of presentational adjustments to the PPE note required to ensure that the accounts are compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 ('the Code'). We understand that the Authority will be addressing these where significant.

Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that it complies with Delivering Good Governance in Local Government: A Framework published by CIPFA/SOLACE and it is not misleading or inconsistent with other information we are aware of from our audit of the financial statements. We have made a number of comments in respect of its format and content which the Authority has agreed to amend where significant.

Narrative Report

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

Pension fund audit

Our audit of the Fund did not identify any significant adjustments. For the audit of the Fund we used a materiality level of £23m. Audit differences below £1m are not considered significant. We anticipate issuing an unqualified audit opinion following approval of the Statement of Accounts by the Audit Committee on 21 September 2016.

We identified a small number of presentational adjustments required to ensure that the accounts are compliant with the Code. We understand that the Fund will be addressing these where significant.

Pension fund annual report

We have reviewed the Pension Fund Report and Accounts 2015-16 and confirmed that 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 Pension Fund Report and Accounts 2015-16 at the same time as our opinion on the Statement of Accounts.

Significant audit risks

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

***Property, Plant and Equipment* – We identified that the write out of accumulated depreciation associated with the derecognition of council dwellings was incorrectly calculated. We have raised a recommendation in relation to this finding in Appendix 2.**

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

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

Valuation of Property, Plant and Equipment

- Risk: The Council has a significant asset base primarily relating to Council dwellings, operational buildings and investment property. The scale of the asset base and the potential for impairment/valuation changes makes this balance inherently risky due to the high level of judgement and estimation uncertainty.
- Findings: As part of our 2015/16 audit, we have reviewed management's assessment of property valuations and impairment calculations; confirmed the information provided to the valuer from the Authority; compared the assumptions made by your valuer to benchmarks and to the assumptions used for 2014/15 for consistency; considered the accounting treatment and valuation of the PFI scheme and disposals/decommissioning of assets; completed testing over new capital additions in year to confirm appropriately capitalised and that Council ownership is evidenced; and reviewed disposals made in year and confirmed appropriate removal from the PPE balance in 2015/16. We found that the write out of accumulated depreciation associated with the derecognition of council dwellings had been incorrectly calculated by the Authority's fixed asset register. The resulting misstatement was not significant; however, we have raised a recommendation in relation to this finding in Appendix 1.

Conditional Grant Income

- Risk: The Council receives grants containing certain conditions. Each grant is awarded on the basis that it will be drawn down at a service level once the specific conditions of the grant have been met. The grant cannot be credited to the comprehensive income & expenditure account until the conditions attached to the grant have been satisfied.
- Findings: As part of our 2015/16 audit, we have reviewed the controls in place to ensure that grants are recognised only when there is reasonable assurance that the Authority will comply with any conditions attached to the grant; ensured that, for a sample of grants, these have been applied over the period necessary to match them with the related costs for which they are intended to compensate, on a systematic basis; and for conditional grants received we ensured that the accounting policy adopted for grants, including method of balance sheet presentation, nature and extent of grants recognised in the financial statements and any unfulfilled conditions and contingencies attaching to recognised grants has been disclosed within the accounts.

  No issues were noted as a result of the work performed.

Significant audit risks

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

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

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

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

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

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Fraud risk of revenue recognition

Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.

In our External Audit Plan 2015/16 we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue. This is still the case.

Since we have rebutted this presumed risk, there has been no impact on our audit work.

Management override of controls

Professional standards require us to communicate the fraud risk from management override of controls as significant. Management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

Our audit methodology incorporates the risk of management override as a default significant risk. We have not identified any specific additional risks of management override relating to this audit.

In line with our methodology, we carried out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.

There are no matters arising from this work that we need to bring to your attention.

Other areas of focus

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

The table sets out our detailed findings for each of the areas of audit focus.

No issues were noted as a result of these procedures.

Accounting for pension fund assets and liabilities - £561m in 15/16 (£702m in 14/15)

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

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

No issues were noted as a result of these procedures.

Payroll - £220m in 15/16 (£202m in 14/15)

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

Findings: We have reviewed and tested reconciliations for gross pay and deductions; reviewed the effectiveness of controls over 25 starters 25 leavers and 25 payroll amendments; completed substantive analytical review of payroll costs; and tested supporting system information used to compile the review.

No issues were noted as a result of these procedures.

Housing Benefits Expenditure - £311m in 15/16 (£319m in 14/15)

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

Findings: We have gained an understanding over controls related to housing benefits expenditure; completed substantive analytical review of rent rebates and rent allowances; and reconciled expenditure to the subsidy claim form.

No issues were noted as a result of these procedures.

Other areas of focus

Non-Payroll Expenditure - £883m in 15/16 (£848m in 14/15)

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

Findings: We have performed substantive tests of detail to agree expenditure to third party documentation and cut-off testing of non-payroll expenditure to ensure costs are recorded in the correct period.

No issues were noted as a result of these procedures.

Cash - £88m in 15/16 (£123m in 14/15)

Audit Focus: Cash has a pervasive impact on the financial statements and provides comfort for other areas of the financial statements.

Findings: We have reviewed the year end bank reconciliation and confirmed cash balances with external third parties, including all school cash balances held by the Authority.

No issues were noted as a result of these procedures.

HRA Rental Income - £114m in 15/16 (£112m in 14/15)

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

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

No issues were noted as a result of these procedures.

Council tax income - £90m in 15/16 (£86m in 14/15)

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

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

No issues were noted as a result of these procedures.

Other areas of focus

Business rates income (NDR) - £86m in 15/16 (£85m in 14/15)

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

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

No issues were noted as a result of these procedures.

HRA Repairs and Maintenance and Management Expenditure - £87m in 15/16 (£86m in 14/15)

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

Findings: We have gained an understanding over controls related to HRA expenditure; tested the operating effectiveness of relevant controls; and completed substantive analytical review of expenditures.

No issues were noted as a result of these procedures.

Significant audit risks and other areas of audit focus - pension fund

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

This section sets out our detailed findings on those areas in relation to the Fund.

No issues were identified through this work.

In our External Audit Plan 2015/16, presented to you in March 2016, we identified one significant risk affecting the Authority's Pension Fund's 2015/16 financial statements. We have now completed our testing of this area and set out our evaluation following our substantive work.

The table below sets out our detailed findings for the risk that is specific to the Pension Fund.

Pension Fund Investments - £1,147m in 15/16 (£1,151m in 14/15)

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

Findings: We have reviewed the valuation of the Pension Fund investments, including the unlisted investments, and considered the independent assurance that is available in respect of the valuation processes and valuations of funds. We have also reviewed the disclosure notes in the light of relevant requirements.

No issues were identified through this work.

Our External Audit Plan also identified one area of audit focus relating to the Fund. The table below sets out our detailed findings for this item.

Pension fund assets and liabilities - £985m in 15/16 (£978m in 14/15)

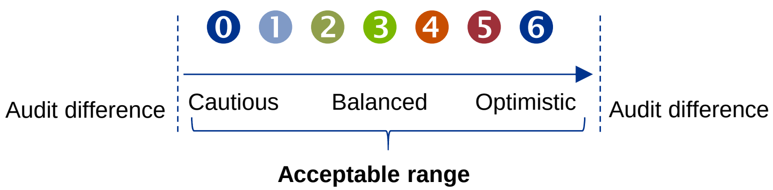
Audit Focus: The 31st March 2016 is the next triennial valuation process for the Pension Fund. Certain pension fund investments are inherently risky to value, include estimation techniques and are subject to judgement by the fund manager when valuing the assets.

Findings: We have carried out an assessment of the actuary under IAS19, reviewing the expert's competence, capabilities and objectivity.

No issues were noted as a result of these procedures.

Judgements

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



Assessment of subjective areas			
Asset/liability class	**15/16**	**Balance (£m)**	**KPMG comment**
Note 21: Provisions	3	£21 million *(PY: £19 million)*	We have reviewed and agreed a sample of the provisions, including the NDR provision, recorded in your financial statements to supporting documentation. The largest provision (£9.7m), in relation to insurance, has been agreed to third party evidence provided by insurers JLT. Based on the above work, we believe the Council has represented a balanced view of provisions, within the acceptable range of estimates.
Note 13: Property, Plant and Equipment (valuations / asset lives)	3	£3,615 million *(PY: £3,076 million)*	We have reviewed management's assessment of property valuations and impairment calculations; confirmed the information provided to the valuer from the Authority; and compared the assumptions made by your valuer to benchmarks and to the assumptions used for 2014/15 for consistency. Overall we have concluded the Authority has made a balanced estimate and that the judgements represent a valid assessment of asset usage.
Note 11: Grants	3	£131 million *(PY: £169 million)*	We noted that grants income is split into £102m of non-ring fenced government grants and £29m capital grants and contributions. For non-ring fenced grants, we selected items with high value or fluctuations from prior year and agreed these back to supporting documentation, including grant receipts to bank statements. For capital grants, we agreed a sample of grants back to supporting documentation and confirmed that conditions have been met to release income. We have performed additional procedures over the Dedicated Schools Grant income, agreeing the budget and award to notification and sample of expenditure items to remittance advice. Based on the above work, we believe the Council has represented a balanced view of grant income recognised in the period.

Judgements

Assessment of subjective areas			
Asset/liability class	**15/16**	**Balance (£m)**	**KPMG comment**
Note 24: Pensions valuation	3	£561 million *(PY: £702 million)*	We have reviewed the actuarial valuation for pensions and considered the assumptions made by your actuaries in comparison to benchmarks, which are collated by our KPMG actuaries, and to the assumptions used for 2014/15 for consistency. Our view is that the Council and its actuaries are balanced in determining the net pension liability and within the acceptable range of estimates.
Other accounting policies	3	N/A	We have reviewed the Authority's accounting policies contained in the financial statements to ensure consistency with the relevant accounting standards and the CIPFA Code. We have also analysed any changes in accounting policy from the previous period. We have determined that the Authority's accounting policies are consistent with those set out in the CIPFA Code, with prior year accounting policies, and are consistent with our understanding of the Authority's application of them.
Note 8: Earmarked Reserves	3	£162 million *(PY: £193 million)*	We have reviewed the Earmarked Reserves disclosure for reasonableness and agreed all significant movements between reserves to confirm they are appropriate and have been authorised by the relevant individual. We believe the Authority's judgement to be balanced.

Accounts production and audit process

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

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

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	We consider that accounting practices at the Authority are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 2 June 2016. A number of queries were raised with respect to the detail included within the Narrative Report and inconsistencies identified between balances in the PPE note and other financial statement notes. The Council has agreed to include further detail to the Narrative Report, for example, around capital investment and funding reductions. We have raised a recommendation relating to the compilation of the fixed assets note in Appendix 1.
Quality of supporting working papers	Our *Accounts Audit Protocol*, which we issued on 15 March 2016 and discussed with the Group Director - Finance and Corporate Resources, 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 in a reasonable time.
Pension Fund Audit	The audit of the Fund was completed alongside the main audit. There are no specific matters to bring to your attention relating to this.

Completion

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

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

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

Declaration of independence and objectivity

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

In relation to the audit of the financial statements of the London Borough of Hackney Council and the London Borough of Hackney Pension Fund for the year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and Authority and the Fund, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 4 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 Group Director - Finance and Corporate Resources for presentation to the Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

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

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

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report.

Section four: Value for Money

VFM Conclusion

Our VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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

We have concluded that the Authority has made proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Background

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

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

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

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

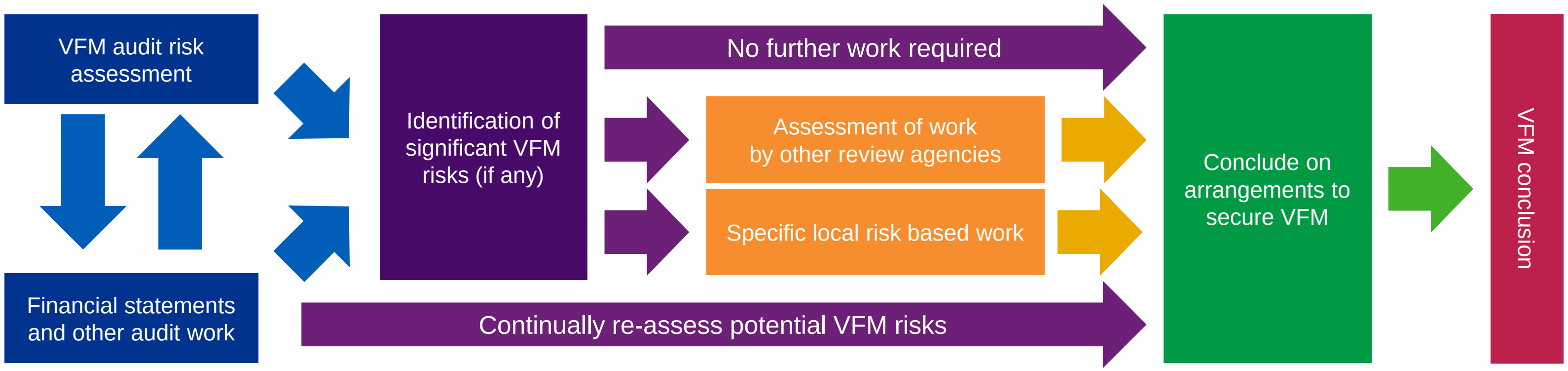
Conclusion

We have concluded that the Authority has made proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Overall criterion

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

Informed decision making	Sustainable resource deployment	Working with partners and third parties
✓ Met	✓ Met	✓ Met



Specific VFM Risks

We identified one specific VFM risk - Sustainable resource deployment

We concluded that we needed to carry out additional work for this area. This work is now complete and no issues were identified.

Work completed

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

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

Key findings

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

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

Key VFM risk	Risk description	Assessment
Sustainable resource deployment	Due to the significant financial challenge in the sector and the financial overspend forecast by the Council, we undertook a detailed consideration of its financial position and financial sustainability. The Council continues to endeavour to bring in the 2015/16 budget, but face significant cost pressures in Temporary Accommodation, Looked After Children and Social Care. The delivery of the savings that formed part of the 2011/12 –2015/16 Financial Plan and beyond is the *Continued overleaf*	We formally considered management's assessment of the Council's ability to continue as a going concern. We performed work to assess the Council's financial sustainability. This included the identification of any significant one-off items included within the reported headline result. We also considered the ability of the Council to maintain a sufficient level of reserves to offer the required financial resilience. **Audit focus based work required: Yes** Through our review of the internal audit reviews, our testing of 11 Cost Improvement Programmes covering 2015-16 and 2016-17, our discussions with the Head of Internal Audit and the Chief Accountant, we have determined that there are proper arrangements in place to ensure that the Authority has achieved value for money in its Sustainable resource deployment.

Specific VFM Risks (continued)

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Sustainable resource deployment (cont.)	most significant change programme in Hackney in recent times; and continues to provide a major challenge to the Council as an organisation. In order to meet the emerging financial challenges the 16/17 budget contains the proposal for a 2% council tax increase which would increase Band D payments by less than £20 a year, but would raise around £1.3m. This is the Councils first proposed Council tax increase for over a decade but reflects the increasingly financially constrained environment that the Council is operating in. Per the 2016/17 budget setting paper, by 2016/17, the Council will have lost £138m funding from central Government since 2010 and will lose a further will lose a further £38m in Government funding over the next four years.	

Appendices

Appendix 1: Key issues and recommendations

Appendix 2: Audit differences

Appendix 3: Materiality and reporting of audit differences

Appendix 4: Independence and objectivity

Key issues and recommendations

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

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

We will formally follow up these recommendations next year.

Priority rating for recommendations					
1	***Priority one***: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	2	***Priority two***: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	3	***Priority three***: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No.	Risk	Issue and recommendation	Management response/ responsible officer/due date
1	2	**Write out of accumulated depreciation associated with the derecognition of council dwellings upon disposal** The write out of accumulated depreciation associated with partially derecognised assets (RTB disposals) is automatically calculated by AIRS, the Authority's fixed asset system. For both 2014/15 and 2015/16, the system did not calculate the write out figure correctly. In 2014/15, the system wrote out an accumulated depreciation figure which was greater than the disposed assets' net book value. This resulted in an overstated depreciation charge for 2014/15. This error has been rectified through the in-year housing stock revaluation exercise. The Authority have reviewed the calculation for both financial years and the accounts have been correctly updated to reflect the 2015/16 accumulated write out, an adjustment of £333k. The adjustment is below our materiality threshold. In addition, a number of inconsistencies were also identified between the fixed asset note and related notes, including the Capital Expenditure and Capital Financing note and the Capital Adjustment Account note. **Recommendation** As part of the accounts close down process, we recommend that the Council manually review in detail, the balance written out of accumulated depreciation related to all assets disposed of during the year. More detailed review of the fixed asset note should be carried out at year end to reduce the number of adjustments required.	Agreed Nish Popat. March/April 2017 The issues encountered are recognised by officers and we are building more time for review of these particular areas into the closedown timetable for 2016/17 accounts. Officers are also reviewing software options to ensure that the current package is the most efficient and will manage with changing capital requirements

Key issues and recommendations

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
2	3	**Trust Funds** The Council administers, as sole trustee, a number of trust funds which have been excluded from its financial statements on the basis that the funds are not owned by the Council. Other than through nominal interest earned, the balances within the funds have not moved for a number of years. The funds are not being used for the purposes for which they were set up, for example, prize awards and war memorial funds. **Recommendation** The Council should review all Trust Funds for which it acts as Trustee and close those which are no longer in use.	Agreed Michael Honeysett March 2017 It must be recognised that the monies available in the Trust Funds are not usable by the Council for its own purposes. Officers are already in discussion with an organisation that specialises in the work required to transfer these balances into a fund that can be sustained over time and then used to the benefit of residents in the borough. This will involve specific work with the charities Commission as they will need to approve the closure of the Trust Funds.

Audit differences

This appendix sets out the audit differences identified during the audit for the year ended 31 March 2016.

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

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

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

Uncorrected audit differences

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

Corrected audit differences

No significant audit differences have been identified from our work.

Presentational adjustments have been made to Current Assets and Long term liabilities on the balance sheet. These adjustments have no effect on the net assets of the Authority.

A non-material adjustment of £333k has been made to Property, Plant and Equipment in order to correct the write out of accumulated depreciation associated with the derecognition of council dwellings upon disposal. See Appendix 1 for recommendation raised in relation to this.

Presentational improvements

A number of minor amendments focused on presentational improvements, including consistency between the PPE note and other financial statement notes, have also been made to the draft financial statements. The Finance Department are committed to continuous improvement in the quality of the financial statements submitted for audit in future years.

Pension Fund

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

Materiality and reporting of audit differences

For 2015/16 our materiality is £15 million for the Authority's accounts. For the Pension Fund it is £23 million.

We report audit differences over £1m to the Audit Committee for both the Authority's accounts and for the Pension Fund. No such items were identified.

Materiality

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

— Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.

— Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.

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

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

Materiality for the Authority's accounts was set at £15 million which equates to around 1.4% percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any 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 £1m for the Authority.

Where management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit 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 £23m which is approximately 1.9% of gross assets.

We design our procedures to detect errors at a lower level of precision, set at £1m for 2015/16.

Declaration of independence and objectivity

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

Requirements

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

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

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

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

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

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

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

Declaration of independence and objectivity (cont.)

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

General procedures to safeguard independence and objectivity

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

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

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

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

Auditor declaration

In relation to the audit of the financial statements of the London Borough of Hackney and the London Borough of Hackney Pension Fund for the financial year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and the London Borough of Hackney and the London Borough of Hackney Pension Fund, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Audit Fees

Our scale fee for the audit was £226,320 plus VAT (£301,760 in 2014/15) for the accounts audit and £21,000 plus VAT (£21,000 in 2014/15) for the Pension Fund. This fee was in line with that highlighted within our audit plan agreed by the Audit Committee in April 2016. Our scale fee for certification of grant claims for Housing Benefits is £38,616 plus VAT (£46,340 in 2014/15). Fees for other grants and claims (Teachers Pension, Pooling Capital Receipts and Decent Homes Backlog Funding Agreement) are £10,000 plus VAT (£10,000 in 2014/15).

Non-audit services

KPMG provide a VAT and All Taxes helpline to the London Borough of Hackney. Fees payable in respect of services provided in 2015-16 were £5,000 plus VAT.

kpmg.com/uk

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

KPMG LLP is multi-disciplinary practice authorised and regulated by the Solicitors Regulation Authority. For full details of our professional regulation please refer to ‘Regulatory Information’ at www.kpmg.com/uk