External Audit Report 2016/17

London Borough of Hackney

—

20 July 2017

Content

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

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

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, 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, Andrew Sayers (0207 694 8981, andrew.sayers@kpmg.co.uk). After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3H.

Important notice

This report is presented in accordance with our PSAA engagement. Circulation of this report is restricted. The content of this report is based solely on the procedures necessary for our audit. This report is addressed to the London Borough of Hackney (the Authority) and has been prepared for your use only. We accept no responsibility towards any member of staff acting on their own, or to any third parties. The National Audit Office (NAO) has issued a document entitled Code of Audit Practice (the Code). This summarises where the responsibilities of auditors begin and end and what is expected from the Authority. External auditors do not act as a substitute for the Authority's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

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

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

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

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

- **Financial statements audit:** finalisation of journals testing, payroll sampling & PPE sampling.
- **Value for money conclusion:** Detailed review of savings plans.
- **Whole of Government accounts pack:** We cannot formally conclude the audit and issue an audit certificate until we have completed the work necessary to issue our assurance statement in respect of the Authority's Whole of Government Accounts consolidation pack. We are satisfied that this work does not have a material effect on the financial statements or on our value for money conclusion.
- **Pension Fund: Administering Authority**: Within our audit opinion on the financial statements, we are required to give an opinion on the consistency of the pension fund included in the Pension Fund Annual Report with the pension fund accounts included in the financial statements. As the authority has not yet prepared the Pension Fund Annual Report we have not issued our report on the financial statements included in the Pension Fund Annual Report. Until we have done so, we are unable to certify that we have completed the audit of the accounts in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice

Summary

Financial statements audit – see section 2 for further details

Subject to all outstanding queries and procedures being satisfactorily resolved we intend to issue an unqualified audit opinion on the Authority's financial statements by the 31 July 2017 following the Audit Committee adopting them and receipt of the management representations letter. This is significantly ahead of the statutory deadline of 30 September 2017 and is aligned to the earlier statutory sign off deadline that will be applicable to all Authorities for the year ended 31 March 2018.

We also anticipate issuing an unqualified audit opinion in relation to the Pension Fund's financial statements, ahead of the deadline of 30 September 2017.

Subject to the matters noted on page 3 we have completed our audit of the financial statements. We have read the Narrative Report and reviewed the Annual Governance Statement (AGS). Our key findings are:

- There is one unadjusted audit difference, explained in section 2 and appendix 2.
- We agreed presentational changes to the accounts with the Corporate finance team. These related to compliance with the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 together with minor changes focussed on streamlining and refining the existing notes to the financial statements. These are set out in Appendix 2.
- The requests we are seeking through management representations are explained in section 2.
- We will report that your AGS complies with delivering Good Governance guidance issued by CIPFA / SOLACE in April 2016.
- We reviewed the Narrative Report and have no matters to raise with you.
- At the time of writing this report we have not received a formal objection, although we are aware of one potential objection that may be received prior to the 21 July. We will provide a further update at the Committee.

The final element of our work which is outstanding is in relation to the audit of your 'whole of government accounts' consolidation pack. Once completed, we will be in a position to issue our completion certificate. We would anticipate completing this prior to 30 September 2017. We also intend to issue our 2016/17 Annual Audit Letter in November 2017.

Value for money – see section 3 for further details

Based on the findings of our work, we have concluded that the Authority has adequate arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified value for money conclusion aligned to the timeline outlined above.

Summary

Other matters

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

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

There are no other matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority's 2016/17 financial statements.

We are satisfied that the Authority has addressed the two recommendations raised in our ISA260 report in 2015/16. We have made no new recommendations as a result of our 2016/17 work.

We undertake work on the Housing Benefits grant claim under the PSAA arrangements, this work will be undertaken in September and completed by the 30 November 2017 deadline. We also undertake other grants and claims work for the Authority that does not fall under the PSAA arrangements. The status of our grants and claim work is summarised below:

- Teachers Pensions: The reporting accountant assurance deadline is the 30 November 2017. We will complete the fieldwork in relation to this in October 2017;
- Pooling of Housing Receipts: The reporting accountant assurance deadline is the 30 November 2017. We will complete the fieldwork in relation to this in October 2017; and
- Skills Funding Agency, subcontracting controls: The reporting accountant assurance deadline was 30 May 2017. The assurance report was submitted on 18 May 2017. No issues were identified.

The fees for this work is explained in section two.

Financial statements audit

We audit your financial statements by undertaking the following:

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

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

1. Business understanding	In our 2016/17 audit plan we assessed your operations to identify significant issues that might have a financial statements consequence. We confirmed this risk assessment as part of our audit work. We provide an update on each of the risks identified later in this section.
2. Assessment of the control environment	We assessed the effectiveness of your key financial system controls that prevent and detect material fraud and error. We found that the financial controls on which we seek to place reliance are operating effectively. We reviewed work undertaken by your internal auditors, in accordance with ISA 610 and used the findings to inform our work. We have chosen not to place reliance on their work due to the approach we adopted for the financial statements audit.
3. Prepared by client request (PBC)	We produced the PBC to summarise the working papers and evidence we ask you to collate as part of the preparation of the financial statements. We discussed and tailored our request with the Chief Accountant and this was issued as a final document to the finance team. We are pleased to report that this has resulted in good-quality working papers with clear audit trails maintained on the KPMG sharepoint database.

Financial statements audit

4. Accounting standards	We work with you to understand changes to accounting standards and other technical issues. For 2016/17 these changes related to: • Updates to the presentation of the Comprehensive Income and Expenditure Statement (CIES) to better reflect local reporting and the Authorities own Directorate structure, changes to the presentation of the Movements in Reserves Statement (MIRS) and the introduction of the new Expenditure and Funding Analysis (EFA). The changes to the EFA are aimed at demonstrating to stakeholders how the funding available to the Authority for the year has been used in providing services, in comparison with those resources consumed or earned by the Authority in accordance with generally accepted accounting practices; • Amended guidance on the Annual Governance Statement (AGS) based on the changes to the 'Delivering Good Governance in Local Government: Framework (2016)' published by CIPFA and SOLACE; and • Changes in the format of the Pension Fund accounts which includes updates to the format of the Fund Account and the Net Asset Statement to be consistent with the new 2015 Pensions SORP and recommendations for a new disclosure on investment management transaction costs (Note 11) No issues were noted with regards to the above.
5. Accounts Production	We received complete draft accounts by 9 June 2017 in accordance with the deadline. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17. We will debrief with Corporate Finance to share views on the final accounts audit which hopefully will lead to further efficiencies in the 2017/18 audit process. We would note that the timetable for the year ended 31 March 2018, formally comes forward to 31 July 2018. We will work with the council to ensure that all elements of both the financial statement and pension fund audit are refined to this deadline to be achieved for both the financial statements and the Pension Fund and associated Pension Fund annual report. We thank Corporate Finance for their cooperation throughout the visit which allowed the audit to progress and complete within the allocated timeframe.
6. Testing	We have summarised the findings from our testing of significant risks and areas of judgement in the financial statements on the following pages. During the audit we identified one unadjusted audit difference (explained in section 2 and appendix 2), the remaining items identified related to presentational issues which have been adjusted.
7. Representations	You are required to provide us with representations on specific matters such as your going concern assertion and whether the transactions in the accounts are legal and unaffected by fraud. We provided a draft of this representation letter to the Director of Finance on 17 July 2017. We draw attention to the requirement in our representation letter for you to confirm to us that you have disclosed all relevant related parties to us. We are not seeking any specific management representations.

Financial statements audit

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

— Significant difficulties encountered during the audit;

— Significant matters arising from the audit that were discussed, or subject to correspondence with Management;

— Other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process; and

— Matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. significant deficiencies in internal control; issues relating to fraud, compliance with laws and regulations, subsequent events, non disclosure, related party, opening balances, public interest reporting, questions/objections, etc.).

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority’s 2016/17 financial statements.

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

- The results of the procedures we performed over the valuation of property, plant and equipment (Authority), significant changes in the pension liability due to LGPS triennial valuation (Authority) , valuation of pension fund assets (Pension Fund) and conditional grant income (Authority) which were identified as significant risks within our audit plan;
- The results of our procedures to review the required risks of the fraudulent risk of revenue recognition and management override of control; and
- Our view of the level of prudence applied to key balances in the financial statements.

Financial statements audit

Significant audit risk	Account balances effected	Summary of findings
Valuation of Property, Plant, and Equipment (PPE) As at 31 March 2017 the value of the Authorities PPE was £4,208 million. Local authorities exercise judgement in determining the current value of different classes of assets held and the methods used to ensure the carrying values recorded each year reflect those current values. The Authority is responsible for ensuring that the valuation of PPE is appropriate at each financial year end and for conducting impairment reviews that confirm the condition of these assets. We have assessed that the inherent uncertainty in valuation and high value of assets held by the Authority creates a significant risk to the financial statements for 2016-17.	**Note 13: PPE** £4,208 million PY £3,615 million (NBV)	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 2015-16 for consistency; • completed testing over new capital additions in year to confirm these are appropriately capitalised and that Authority ownership is evidenced; and • reviewed disposals made in year and confirm appropriate removal from the PPE balance in 2016-17. **There are no issues that we need to bring to your attention.**
Conditional Grant Income The Authority 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.	**Note 11: Grant Income** £23.8 million PY £28.7 million	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 for a sample of grants, that they have been applied over the period necessary to match them with the related costs, for which they are intended to compensate, on a systematic basis; and • we have ensured that the accounting policy adopted for grants, including method of balance sheet presentation, nature and extent of grants recognised in the financial statements and any unfulfilled conditions and contingencies attached to recognised grants has been disclosed within the accounts. **There are no issues that we need to bring to your attention.**

Financial statements audit

Significant audit risk	Account balances effected	Summary of findings
Pension liability including assumptions and having regard to the potential for significant changes arising from the LGPS Triennial Valuation In accordance with the Code, the Authority is required to include a liability within the net assets on its balance sheet in respect of the Hackney and LPFA Pension Funds. This shows an increase in the liability of £155 million to a net total liability of £722 million. The associated costs have been included within the CIES. The impact of this has been mitigated by a net transfer from the Pensions Reserve. During the year, the Pension Fund has undergone a triennial valuation with an effective date of 31 March 2016 in line with the Local Government Pension Scheme (Administration) Regulations 2013. The share of pensions assets and liabilities for each admitted body is determined in detail, and a large volume of data is provided to the actuary to support this triennial valuation. The pension numbers to be included in the financial statements for 2016-17 are based on the output of the triennial valuation rolled forward to 31 March 2017. For 2017-18 and 2018-19 the actuary will then roll forward the valuation for accounting purposes based on more limited data. There are significant judgments made in relation to the assumptions to be adopted when calculating the pension liability.	**Balance sheet:** Long Term Liabilities: £735 million, **£721 million** relates to the Pension Fund Liability. PY: Long Term Liabilities: £581 million **£566 million** related to the Pension Fund liability.	As part of our audit of the Pension Fund Liability, we have undertaken work on a test basis to agree the data provided to the actuary back to the systems and reports from which it was derived and to understand the controls in place to ensure the accuracy of this data. This work focussed on the data relating to the Authority itself as largest member of the Pension Fund. We also reviewed the assumptions adopted in calculating the pension liability using the work of independent experts engaged by the NAO, together with a review by the KPMG Pensions team. **There are no issues that we need to bring to your attention.**

Financial statements audit

Significant audit risk	Account balances effected	Summary of findings
Valuation of Pension Fund Assets (Pension Fund) At 31 March 2017 the Pension Fund had investment assets totalling £1,391 million. The investment portfolio includes contracts which can be complex to value, those being level 2 (£909M) and level 3 (£145K) assets. Given the size and potential for complexity in the investment portfolio we consider this to be a significant audit risk for 2016-17.	**Pension Fund Net Asset Statement** Net Assets: £1,391 million PY: £1,172 million	We have: • undertaken detailed testing of investments including assessing the design and operation of controls in place; • obtained independent confirmations from the Custodian (and Fund Managers as necessary) to verify year end balances; • undertaken substantive testing over sales and purchases made in the year, reviewing year on year movements, and comparing performance to known benchmarks. **There are no issues that we need to bring to your attention.**

Financial statements audit

Other areas of audit focus

We identified seven other areas of audit focus. These are not considered to be significant risks as they are less likely to give rise to a material error. Nonetheless these are areas of importance where we carry out audit procedures to ensure that there is no material misstatement.

Other areas of audit focus	Account balances effected	Summary of findings
Disclosures associated with restatement of CIES, EFA and MiRS	N/A	We have: • assessed how the Authority has actioned the revised disclosure requirements for the CIES, MiRS and the new EFA statement as required by the Code; and • checked the restated numbers and associated disclosures for accuracy , correct presentation and compliance with applicable Accounting Standards and Code guidance. **There are no issues that we need to bring to your attention.**
Note 28: Payroll	£226 million PY £220 million	We have: • tested reconciliations for gross pay and deductions (e.g. pensions, tax and national insurance); and • Substantively tested the payroll balance using statistical sampling. We tested 24 items (20 positive values and 4 negative values), with a value of £18,391,589 and £21,954,594 respectively. **We identified that there was a presentational error in Note 28(B). The Employee expenses figure should be presented as £218M, as opposed to £226M as presented in the draft financial statements. This does not impact on the CIES. We have agreed this adjustment with the Council and included this within Appendix 3 to this report.**
Note 19: Cash & cash equivalents	£67.8 million PY £87.8 million	We have: • reviewed the year end bank reconciliation; • confirmed cash balances with external third parties; and • reviewed, on a sample basis, school cash balances held by the Authority. **No issues were noted as a result of these procedures**

Financial statements audit

Other areas of audit focus	Account balances effected	Summary of findings
Note 28: Non-Payroll Expenditure Note 22: Creditors	£878 million PY: £919 million £112 million PY: £102 million	We have: • agreed a statistical sample of non pay expenditure to third party documentation to confirm classification per the Code; • undertaken cut-off testing, whereby we test a sample of transactions in the period between the 31 March 2017 and the ledger close to ensure these are recorded in the correct period; and • statistically selected a sample of short term creditors and confirmed classification to source documentation. **Within our cut off testing, we identified two capital accruals which had been recorded within the incorrect financial period. These totalled £2.4 million. The transactions related to 2016/17, but were recorded within 2017/18, understating capital expenditure in the 2016/17 financial statements. Following discussion of the error with management, the authority subsequently reviewed all transactions processed by the individuals who had incorrectly classified the transactions within our sample. Two further errors were found, creating a total error of £3.3 million. Of the remaining sample, no further errors were found. The errors identified are not material individually, or in aggregate. The error does not appear to be persistent or pervasive. This error remains unadjusted in the financial statements.**
Note 21: NNDR appeals provision	£2.9 million PY: £3.0 million	The Authority use an independent body to calculate the appeals provision. We have: • gained an understanding over controls related to business rates income and specifically the appeals process; • reviewed the methodology applied in determining the appeal provision including whether this reflects a balanced, cautious or optimistic assessment; and • ensured the report is complete by agreeing the total on the summary tab to the VOA data submitted by the Authority. **There are no issues that we need to bring to your attention.**
HRA: Rental Income	£140 million PY £141 million	We have: • gained an understanding over controls related to HRA rental income; • tested the operating effectiveness of relevant controls; and • completed substantive analytical review of dwelling rent income and reconcile HRA amounts to the Authority's CIES. **There are no issues that we need to bring to your attention.**

Financial statements audit

Other areas of audit focus	Account balances effected	Summary of findings
HRA: Repairs and Maintenance and Management Expenditure & Supervision and Management	R&M £38.9 million PY £44.2 million S&M: £38.0 million £42.9 million	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. We have also linked our work to that over payroll and non-payroll expenditure. **There are no issues that we need to bring to your attention.**

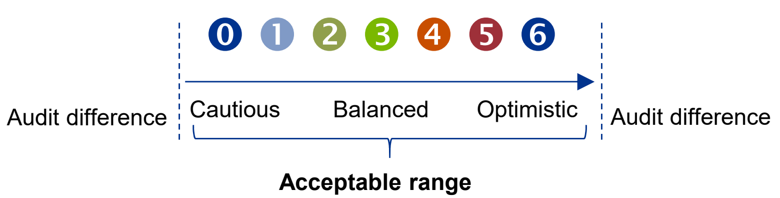
Financial statements audit

Significant risks that ISAs require us to assess in all cases	Why	Our findings from the audit
Fraud risk from revenue recognition	Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. We do not consider this to be a significant risk for the majority of the Authority's income as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk for council tax, business rates, housing rents, annual central government grants and social services income and do not incorporate specific work into our audit plan in these areas over and above our standard fraud procedures. However, we do consider it for income relating to s106 monies that span financial years and often have to be used on specific projects.	For other income, we obtained a breakdown of Cost of Services and removed Grant income credited to services. We removed the conditional grant element and tested this as below: • We classified conditional grant income as a significant audit risk for 2016/17 and have outlined above the audit work we undertook which also fulfilled our responsibilities for this objective. Other income was tested as an other account within our audit work. • Other areas of income, for example taxation and precepts were tested for completeness. **There are no matters arising from this work that we need to bring to your attention.**
Fraud risk from management override of controls	Management is typically in a powerful position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual. We have not identified any specific additional risks of management override relating to this audit.	Our procedures, including testing of journal entries, accounting estimates and significant transaction outside the normal course of business, no instances of fraud were identified. We have performed specific procedures to: • review accounting judgements which are impacting the reported outturn position (see pages 16 and 17); • review of controls associated with, and undertaken, sample testing of manual journals; • reconciled the year end performance to in year financial report to ensure that divergence in performance can be understood and justified; and • reviewed the year end cut off process to ensure that revenue and expenditure items have been reflected within the correct period. **There are no matters arising from this work that we need to bring to your attention.**

Financial statements audit

Judgements in your financial statements

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



Assessment of subjective areas				
Asset / liability class	**Current year**	**Prior year**	**Balance**	**KPMG comment**
Note 21: Provisions (excluding NDR)	3	3	£18.3 million (PY:£18.0 million)	We have reviewed and agreed a sample of the provisions, excluding 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 Authority has represented a balanced view of provisions, within the acceptable range of estimates.
Note 21: NDR provisions	3	3	£2.9 million (PY:£3.0 million)	In 2013/14, local authority funding arrangements meant that the Authority is now responsible for a proportion of successful rateable value appeals. The Authority has provided for a fixed percentage of outstanding appeals in accounting for the potential liability, based on historical appeals success rates. Based on the above work, we believe the Authority has represented a balanced view of provisions, within the acceptable range of estimates.

Financial statements audit

Assessment of subjective areas				
Asset / liability class	**Current year**	**Prior year**	**Balance**	**KPMG comment**
Note 13 PPE: HRA assets	3	3	£2,374 million (PY: £2,012 million)	The Authority continues its use of the beacon methodology in line with the DCLG's *Stock Valuation for Resource Accounting* published in November 2016. The Authority has utilised their internal valuation expert to provide valuation estimates. Our KPMG valuation specialist has met with the Authority specialists and both discussed and reviewed the valuation approach. We deem that the valuation exercise is in line with the instructions. Overall we have concluded the Authority has made a balanced estimate and that the judgements represent a valid assessment of asset usage.
Note 13 PPE: asset lives	3	3	n/a	We have reviewed management's assessment of property valuations and impairment calculations; confirmed the information provided to the valuer from the Authority; and compared the assumptions made by your valuer to benchmarks and to the assumptions used for 2015/16 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 1: Accounting policies	3	3	n/a	We have reviewed the Authority's accounting policies contained in the financial statements to ensure consistency with the relevant accounting standards and the CIPFA Code. We have also analysed any changes in accounting policy from the previous period. 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	3	GF: £138 million PY £162 million HRA: £17.4 million PY £2.5 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 have noted an increase in the balance of the earmarked HRA rightsizing reserve from £1,000 at 31 March 2016, to £12 million at 31 March 2017. This reserve relates to the funding of specific projects, such as the transitioning of Hackney Homes in house and the transformational programme. It will also be used for the replacement programme of the Housing Management system. We believe the Authority's judgement to be balanced.

Financial statements audit

Narrative report of the Authority

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

Pension fund audit

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

Pension fund annual report

We reviewed the consistency of the Fund's financial statements in the Fund's Annual Report and the financial statements included in the London Borough of Hackney's financial statements. We confirm that the Fund's financial statements are consistent with the pension fund financial statements included in the accounts of London Borough of Hackney. We read the information in the Fund's Annual Report to identify material inconsistencies with the Fund's financial statements. The full annual report narrative has not yet been prepared. Once this is prepared, we will review it to ensure there are no material inconsistencies with the financial statements. We anticipate receipt of this in August 2017. The pension fund annual report is not required to published until December 2017.

Queries from local electors

We did not receive any questions or formal objections from members of the public this year at the time this report was issued.

Audit certificate

In order for us to issue an audit certificate, we are required to have completed all our responsibilities relating to the financial year. We are not in a position to issue our audit certificate with the audit opinion as:

— HM Treasury only has recently issued its guidance for completing the WGA and issued the consolidation packs that authorities need to complete. The deadline for the Authority to prepare the consolidation pack was 7 July. We received this on 18 July.   The audit certification deadline is 29 September 2017. We aim to complete this work in July and August 2017.

— We have not yet received a draft Pension Fund Annual Report. The deadline for the Authority to publish this is 1 December 2017 but we expect to be able to issue our audit report for the Pension Fund Annual Report in August 2017 to allow early publication.

As we have not received any objections to the accounts from local electors, therefore we expect to issue our audit certificate in September 2017 following completion of the above.

Financial statements audit

Other grants and claims work

We undertake other grants and claims work for the Authority. The status of our grants and claim work is presented below:

- Housing Benefit grant claim: This work will commence in September 2017 to ensure sign off via the 30 November 2017;
- Teacher pensions contribution return: This work will commence in October 2017 to ensure sign off via the 30 November 2017;
- Pooled housing capital receipts: This work will commence in October 2017 to ensure sign off via the 30 November 2017; and
- Subcontracting controls assurance: This work was completed in April 2016 and certified in May 2016 in accordance with the deadline of 31 May 2017.

Audit fees

Our fee for the audit was £226,320 excluding VAT (£226,320 excluding VAT in 2015/16). This fee was in line with that highlighted in our audit plan approved by the Audit Committee on 20 April 2017.

Our work on the certification of Housing Benefits (BEN01) is planned for September 2017. The planned scale fee for this is £34,755 excluding VAT (£38,616) excluding VAT in 2015/16). Planned fees for other grants and claims which do not fall under the PSAA arrangements is £11,500 excluding VAT (£10,000 excluding VAT in 2015/16).

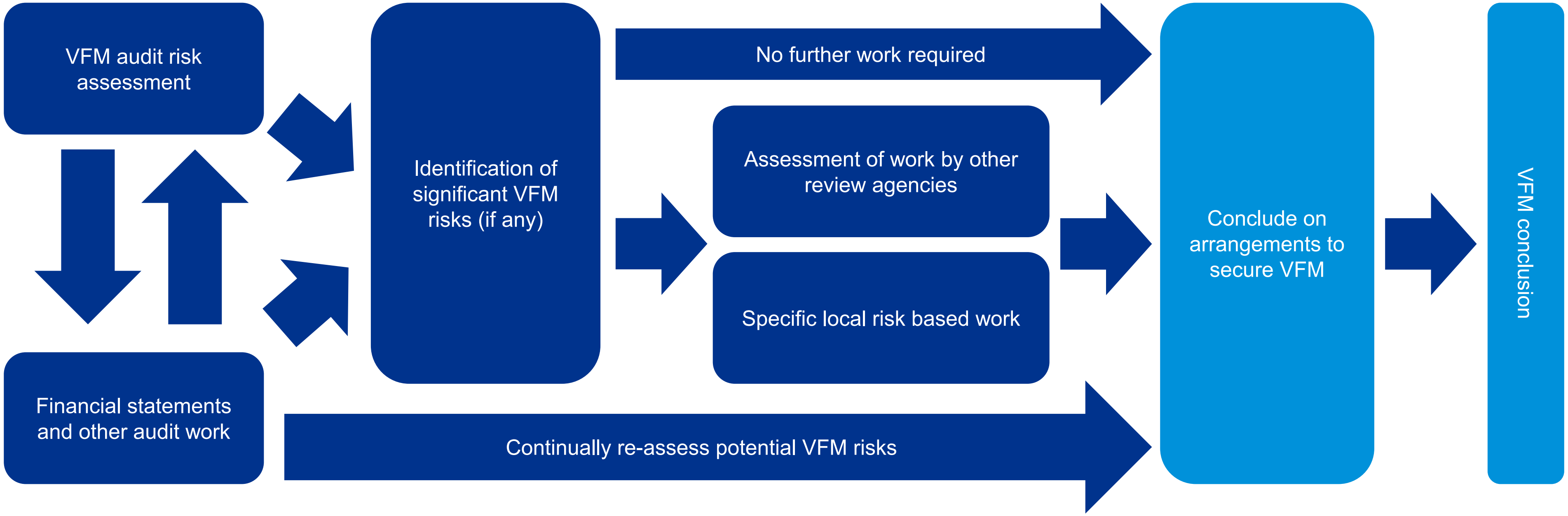
We have completed one piece of non-audit work at the Authority in year as part of a due diligence assistance based on publicly available information. The fee for this work was £38,000 excluding VAT. In 2015/16, KPMG provided a VAT and All Taxes helpline to the London Borough of Hackney. Fees payable in respect of services provided in 2015-16 were £5,000 plus VAT. This service was not provided in 2016/17.

We have included in appendix 4 confirmation of the safeguards that have been put in place to preserve our independence.

Value for money

For 2016/17 our value for money (VFM) work follows the NAO's guidance. It is risk based and targets audit effort on the areas of greatest audit risk. Our methodology is summarised below. Per our audit plan, we have not identified any significant VfM risks. The risk assessment process is dynamic, and we are alert throughout the audit to the possibility that risks may have emerged. Those areas on which our VfM work focussed are detailed below.

We are satisfied that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2017, based upon the criteria of informed decision making, sustainable resource deployment and working with partners and third parties.



Value for money

VFM: other area of audit focus	Our audit response and findings
Informed decision making: Risk Management Effective risk management is an essential part of good governance and a key component of the overall governance framework. It provides a systematic, consistent and efficient way through which risk can be identified, reported and mitigated. It supports informed decision making thereby enabling opportunities to be exploited, or action to be taken to mitigate or manage risk to an acceptable level.	▪ We considered in detail the risk management process and reviewed how risks are captured at a Directorate level and escalated/reported throughout the Authority. We also considered how this is done for large capital projects to see if that process has been followed. ▪ The risk framework is set out in the risk management policy. This clearly articulates the Authorities risk appetite, tolerances and wider risk management process together with the expected flow of information from those identifying the risks to those charged with governance. ▪ Business risks are recorded on a risk register, linked to core objectives. The corporate register is supported by Directorate registers providing a greater level of granularity to underlying risks and associated controls. The Directorate registers are reviewed at each Audit Sub Committee meeting on a rolling basis. ▪ We looked in detail at two of the Directorate risk registers to gain a better understanding of the risk management process. We considered the risk registers at two points within the year to evidence the movement and mitigation of risk throughout the year. ▪ Directorate registers are reviewed at least once a year. Discussions and workshops occur at service and divisional levels to ensure that that risks are updated and new risks captured. The updated register is discussed at a Directorate Management Team (DMT) meeting and any revisions suggested are implemented by the relevant senior managers. ▪ In addition to the Directorate risk management processes, we have also considered the risk registers associated with large capital projects, an area of increased activity over the last 12 months and indeed going forward. We looked at one capital project in detail, Hackney Walk, to consider as to whether risks had been effectively identified and captured in accordance with the risk management policy. ▪ We have reviewed a number of nationally provided performance metrics to inform our assessment. These did not identify any additional areas of focus or significant risks. **There are no matters arising from this work that we need to bring to your attention.**

Value for money

<table>
<tr><th>VFM: other area of audit focus</th><th>Our audit response and findings</th></tr>
<tr><td>Sustainable resource deployment: Medium Term Financial Planning

Central Government cuts mean that in 2016/17 Hackney must work with £110 million less a year than in 2010, while rising costs and increased demand for services has added a further £42 million of expenditure for the Authority to find each year. Against this backdrop, the Authority also agreed to a 2% increase in Authority Tax for the first time in over a decade.

The Authority delivered an underspend of £0.5 million against its revenue budget. This was against a backdrop of reduced funding and increased savings requirements.

The capital expenditure outturn for 2016/17 is £268 milion, £54 million above the final approved budget of £214 million.</td><td>▪ Whilst successfully delivering against the revenue outturn position, there were some significant financial challenges underlying this. Childrens, Adults and Community Health (CACH), specifically Adult Social Care, has been an ongoing area of challenge during 2016/17, with an overspend of £2.6 million related to Care Support Commissioning. The reasons for the overspend have been reported to those charged with governance and mitigating actions taken going forward.

▪ We would note that there has been a movement in the Authorities balance sheet, specifically within the year end net working capital position. Both short term debtors and creditors (specifically other entity balances) have increased, whilst at the year end, a £85 millon increase short term borrowing has the impact of moving the balance sheet into a current net liability position. We would note that at present there is a still £35m of this repayable during July and August.

▪ We reviewed the controls and governance surrounding the budget setting and in year monitoring. We considered management's assessment of the Authorities ability to continue as a going concern. We performed work to assess the Authorities financial sustainability. This included the identification of any significant one-off items included within the reported headline result. We considered the ability of the Authority to maintain a sufficient level of reserves to offer the required financial resilience.

▪ We reviewed the future financial forecasts for the Authority. This included performing an analysis of the forecast run rate position including consideration of the core assumptions in the 2017/18 budget. We have considered the extent to which recurrent saving schemes were achieved in 2016/17 and identified for 2017/18. We selected a sample of cost savings measures and review these to ensure that proper arrangements have been implemented to ensure that resources are deployed to achieve planned and sustainable outcomes. We considered the granularity of the information reported throughout the governance process – specifically in relation to key metrics selected by the Authority within their reporting

▪ The Authority are an facing external funding loss of at least £28 million with significant cost pressures and risks from 2017/18 to 2019/20. £12.5 million of savings have been agreed to set against the funding loss and identified cost pressures. A number of significant cost pressures have been identified including the impact of the introduction of 100% Business Rates, abolition of RSG together with ongoing pressures in childrens services and finding housing needs.

▪ The Capital Programme key priorities are to deliver significant regeneration of the Borough to meet the changing needs and demographics of the community. This in itself leads to cost pressures, through repairs and maintenance of current sites and the need to build new assets to meet demand.

There are no matters arising from this work that we need to bring to your attention.</td></tr>
</table>

Value for money

VFM: other area of audit focus	Our audit response and findings
Informed decision making, sustainable resource deployment, and working with partners and third parties - Hackney Homes ■ Hackney Homes Ltd, an Arms Length Management Organisation (ALMO) was set up by the Authority in April 2006 to manage and maintain the Authorities housing properties and improve the quality of service provided to tenants. The Authority continued to exercise statutory and strategic housing responsibilities and retained a key housing role as owner and landlord. ■ In 2006, consent from the then Office of the Deputy Prime Minister to set up Hackney Homes for a maximum period of ten years was provided. The initial contract period of 5 years expired in 2011. In July 2010 and April 2013, Cabinet agreed an extension of the contract for a further 3 and 2 years respectively. Following a statutory consultation exercise in August to October 2014, it was agreed that the service should be brought back in house when the Hackney Homes Ltd contract expired in March 2016. This timeline coincided with the completion of the Decent Homes programme.	We are required to consider the arrangements that this Authority ■ The management of the Authorities housing stock returned from Hackney Homes to the Authority with effect from 1 April 2016. The Authority is committed to a Housing Estate Regeneration Programme that will deliver over 2,700 new homes over the next ten years. The development of these homes is being led by the Housing Directorate. ■ We considered the governance arrangements in place, both in terms of the winding up and dissolution of Hackney Homes Ltd and the integration within the Authority; ■ We considered the controls surrounding the management of counterparty risk following the service transfer – including, how data protection requirements have been applied following any contractual movements and consideration of the management of financial risks; and ■ For contracts more widely, we considered the process for managing contracts entered into by the Authority to ensure that performance objectives are being achieved and any delivery issues are being managed in accordance with agreed governance requirements. We selected two contracts and review these in detail. ■ We have also considered the wider partnership agreement in place, and remain alive to the ongoing discussions with City and Hackney CCG regarding the development of integrated commissioning for health and social care. **There are no matters arising from this work that we need to bring to your attention.**

Appendix 1

Recommendations raised and followed up

There are no new recommendations for 2016/17. We have followed up the recommendations from the prior year's audit, in summary:

Total number of recommendations	Number of recommendations implemented	Number outstanding (repeated below):
2	2	0

The recommendations raised in 2015/16 related to the:

- Write out of accumulated depreciation associated with the derecognition of council dwellings upon disposal; and
- The administration of Trust Funds.

Both of these areas were promptly actioned following the 2015/16 audit.

Materiality and reporting of audit differences

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

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

We used the same planning materiality reported in our External Audit Plan 2016/17, presented to you in April 2017.

Materiality for the Authority's accounts was set at £15 million which equates to around 1.5% of gross expenditure.

Materiality for the Pension Fund was set at £23 million which equates to around 1.7% of gross assets.

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

Reporting to 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 both the Authority and the Pension Fund, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £750K.

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.

Appendix 3

Audit differences

Unadjusted audit differences

Under UK auditing standards (ISA (UK&I) 260) we are required to provide the Audit Committee with a summary of unadjusted audit differences (including disclosure misstatements) identified during the course of our audit, other than those which are 'clearly trivial', which are not reflected in the financial statements. In line with ISA (UK&I) 450 we request that you correct uncorrected misstatements. However, they will have no effect on the opinion in our auditor's report, individually or in aggregate. As communicated previously with the Audit Committee, details of all adjustments greater than £750K are shown below.

Authority unadjusted audit differences (£'000)

#	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Comments
1			Dr Assets £3,280k	Dr Creditors £3,280k		This relates to 4 transactions whereby the capital payments had been recorded within the incorrect financial period. The transactions related to 2016/17, but were recorded within 2017/18, understating capital expenditure in the 2016/17 financial statements. This difference remains unadjusted in the financial statements.
			Dr £3,280k	**Cr £3,280k**		**Total impact of uncorrected audit differences**

Audit differences

Adjusted audit differences

To assist the Audit Committee in fulfilling its governance responsibilities we have detailed below a summary of adjusted audit differences identified during the course of our audit.

No significant unadjusted audit differences have been identified from our work.

Presentational improvements

Presentational adjustments have been made as follows: These differences related solely to disclosure notes within the accounts, and therefore these adjustments have no effect on the net assets of the Authority. The improvements below have been included in the financial statements.

- Note 13: Capital commitments within note 13 were overstated by £3,432k. This was made up of an overstatement of £4,418k due to a formula error identified within the source spreadsheet used to calculate the commitment. We are satisfied this was an isolated incident relating to the specific source spreadsheet. This amount was then offset by an understatement of £986k where the commitment was incorrectly excluded from the note all together.
- Note 29: Trading Operations, we highlighted to the finance team that the presentation of this would be improved through tabular presentation. An example was provided.
- Note 32: External Audit Costs, was understated by £4k. This amount related to the Learning Grants audit which is new in 2016/17 and it was agreed that this figure would be added to the note to reflect the work to be completed relating to the 2016/17 financial year.
- Note 34, Officers' Remuneration, was found to be understated in terms of post holder details and the associated amounts. Specifically, the data related to the post of the Head of Regeneration, was not included.. It was subsequently agreed that the remuneration figures should be added for this position.
- Our review of Note 34 also highlighted that a number of payments were made to senior officers (primarily the Chief Executive £24k) with regards to their ARO role. Whilst this amount is paid to the Authority by government, we suggested all such payments be disclosed within the year for transparency purposes. It was agreed this would be added to the note.
- Note 44: Liabilities in relation to Hackney homes have been presented net and could not be agreed back to source documentation. This has been corrected such that the figures reconcile back to the valuation reports.

Pension Fund

We are pleased to report that there are no uncorrected or corrected audit differences to the pension fund as at the date of this report.

Appendix 3

Audit differences

<u>Presentational improvements to be amended.</u>

Note: The amendments outlined below are not included in the version of the financial statements circulated to the Audit Committee. These will be included in the final published version. If there are further amendments identified between the date of issuing this report and the date of the audit committee, we will verbally update the committee on these adjustments at the meeting.

- Balance sheet: Reclassification of £14,236 out of long term investments and into short term investments.
- Note 8: Earmarked Reserve: An additional line was added to this note to ensure a read across between the EFA and the Reserves.
- Note 34: Exit payments headcount numbers and values to be amended to reflect contractually committed cost as at 31 March 2017.
- Note 28: Employee expenses figure to be reduced by £8M, with the same amount added to other service expenses.
- Note 7: Whilst completing our consistency check of the accounts we found that ‘capital expenditure charged against the GF and HRA balances’ figure was inconsistent between note 7 and the Capital Adjustment Account. It was agreed that this would be looked into so the two figures reconciled.

Appendix 4

Audit independence

This appendix communicates all significant facts and matters that bear on KPMG LLP's independence and objectivity and informs you of the requirements of *ISA 260 (UK and Ireland) Communication of Audit Matters to Those Charged with Governance.*

Integrity, objectivity and independence

We are required to communicate to you 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 KPMG LLP's independence and the objectivity of the Engagement Lead and audit team. We have considered the fees paid to us by the Authority for professional services provided by us during the reporting period. We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies all KPMG LLP audit partners and staff annually confirm their compliance with our Ethics and Independence Manual including in particular that they have no prohibited shareholdings. Our Ethics and Independence Manual is fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through: instilling professional values; communications; internal accountability; risk management; and independent reviews. We would be happy to discuss any of these aspects of our procedures in more detail. There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed.

Audit matters

We are required to comply with *ISA (UK and Ireland) 260 Communication of Audit Matters to Those Charged with Governance* when carrying out the audit. ISA 260 requires that we consider the following audit matters and formally communicate them to those charged with governance:

- Relationships that may bear on the firm's independence and the integrity and objectivity of the audit engagement lead and audit staff;
- The general approach and overall scope of the audit, including any expected limitations thereon, or any additional requirements;
- The selection of, or changes in, significant accounting policies and practices that have, or could have, a material effect on the Authority's financial statements;
- The potential effect on the accounts of any material risks and exposures, such as pending litigation, that are required to be disclosed in the financial statements;
- Audit adjustments, whether or not recorded by the entity that have, or could have, a material effect on the Authority's financial statements;
- Material uncertainties related to events and conditions that may cast significant doubt on the Authority's ability to continue as a going concern;
- Disagreements with Management about matters that, individually or in aggregate, could be significant to the Authority's financial statements or the auditor's report. These communications include consideration of whether the matter has, or has not, been resolved and the significance of the matter;
- Expected modifications to the auditor's report;

Appendix 4

Audit independence

- Other matters warranting attention by those charged with governance, such as material weaknesses in internal control, questions regarding management integrity, and fraud involving management; and
- Any other matters agreed upon in the terms of the audit engagement.

We continue to discharge these responsibilities through our attendance at Audit Committees, commentary and reporting and, in the case of uncorrected misstatements, through our request for management representations.

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 2017 we confirm that there were no relationships between KPMG LLP and the London Borough of Hackney and the London Borough of Hackney Pension Fund, their directors and senior management and their affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We summarise overleaf the non-audit services that we have provided, the fee, the potential threats to auditor independence and the associated safeguards in place.

Audit independence

Description of non audit services	2016-17 fees	Potential threat to auditor independence	Associated safeguards in place
Due diligence assistance based on publically available information	£38,000, excluding VAT	There are six potential threats: Self-review; Management; Advocacy; Intimidation; Familiarity; Self-interest; and Assuming management responsibility	In determining that the firm can provide this non-audit service we have exercised professional judgement to evaluate the threats to independence, ensured that applied safeguards are sufficient to reduce threats to a level where it is probable that an objective, reasonable and informed third party would conclude that integrity is not compromised. In summary, the scope of the services is agreed under a separate terms of engagement from the financial statements audit. • The fees for the services are not material to the Authority or KPMG. • The service was delivered by a team separate to the audit team. • The services do not have an impact on the financial statements and did not involve reviewing any controls at the Authority. • The role of KPMG was limited to analysis of publicly available information. Any decisions arising would be taken by management (The Director of Finance) who is suitably qualified and knowledgeable to make any associated decisions.
Non PSAA grant claims	£11,000 excluding VAT*	No threats to auditor independence arise	This is a service typically performed by external auditors, no specific safeguards are necessary.
Total fees	£49,000 excluding VAT		
Total fees as a % of the external audit fees	21%		

**For the purposes of PSAA monitoring, £4K of this amount was billed in a different monitoring period.*

We have considered the ratio of audit to non-audit fees and as required by the APB Ethical Standards. The principal threat which arises from fees from non-audit services which are large in absolute terms relative to the audit fee is the perception of self-interest and advocacy. In this regard, we do not consider that the above ratio creates such a self-interest or advocacy threat since the absolute level of non-audit fees is not significant to our firm as a whole and neither the audit partner nor members of the audit team are incentivised on, or rewarded in respect of, the provision of non-audit services to you. We believe that the question of perception is best addressed through appropriate disclosure as to use of the auditor for the provision of non-audit services in the Authority's annual report and accounts.

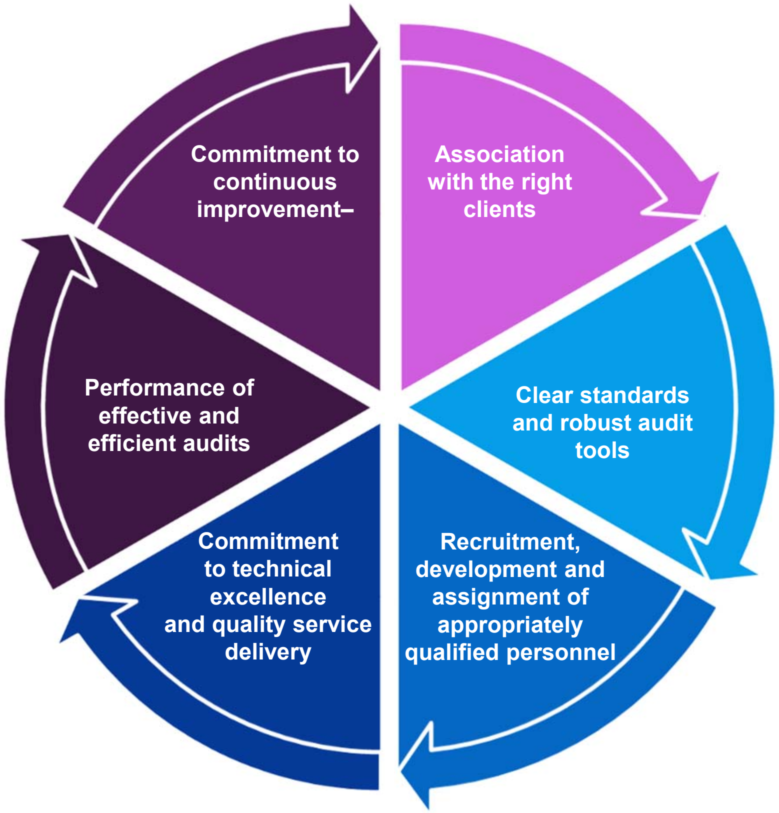
Appendix 5

Audit quality framework

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

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

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



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

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

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

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

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