



External Audit Plan 2015/2016

London Borough of Harrow and Pension Fund

14 January 2016

Financial Statement Audit



There are no significant changes to the Code of Practice on Local Authority Accounting in 2015/16, which provides stability in terms of the accounting standards the Authority need to comply with.

This plan sets out our approach for auditing the Authority financial statements and the Pension Fund financial statements.

Materiality

Materiality for planning purposes has been set at **£6 million** for the Authority and **£7 million** for the Pension Fund.

We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance and this has been set at **£300,000** for the Authority and for the Pension Fund.

Significant risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error for the Authority have been identified as:

- Management override of controls,
- Fraudulent revenue recognition; and
- Valuation of Property, Plant and Equipment.
- Investment valuation (Pension Fund)

Other areas of audit focus

Those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding have been identified as:

- Financial Planning,
- Pension Liability assumptions;

- Grant income recognition; and
- Calculation of benefits (Pension Fund).

See pages 4 to 6 for more details.

Value for Money Arrangements work



The National Audit Office has issued new guidance for the VFM audit which applies from the 2015/16 audit year. The approach is broadly similar in concept to the previous VFM audit regime, but there are some notable changes:

- There is a new overall criterion on which the auditor's VFM conclusion is based; and
- This overall criterion is supported by three new sub-criteria.

Our risk assessment is ongoing and we will report VFM significant risks during our audit.

See pages 8 to 10 for more details.

Logistics



Our team is:

- Andy Sayers, Partner
- Emma Larcombe, Manager
- Jess Hargreaves, Assistant Manager

More details are on **page 13**.

Our work will be completed in four phases from January to September and our key deliverables are this Audit Plan and a Report to Those Charged with Governance as outlined on **page 12**.

Our fee for the audit is £150,725 for the Authority and £21,000 for the Pension Fund see **page 11**.

Background and Statutory responsibilities

This document supplements our Audit Fee Letter 2015/16 provided in April 2015, which also sets out details of our appointment by Public Sector Audit Appointments Ltd (PSAA).

Our statutory responsibilities and powers are set out in the Local Audit and Accountability Act 2014 and the National Audit Office's Code of Audit Practice.

Our audit has two key objectives, requiring us to audit/review and report on your:

- *Financial statements (including the Annual Governance Statement):* Providing an opinion on your accounts; and
- *Use of resources:* Concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the value for money conclusion).

This plan considers both the Authority financial statements as well as the Pension Fund financial statements.

The audit planning process and risk assessment is an on-going process and the assessment and fees in this plan will be kept under review and updated if necessary.

Acknowledgements

We would like to take this opportunity to thank officers and Members for their help and co-operation throughout our initial work with the Authority.

Financial Statements Audit

Our financial statements audit work follows a four stage audit process which is identified below. Appendix 1 provides more detail on the activities that this includes. This report concentrates on the Financial Statements Audit Planning stage of the Financial Statements Audit.



Value for Money Arrangements Work

Our Value for Money (VFM) Arrangements Work follows a five stage process which is identified below. Page 7 provides more detail on the activities that this includes. This report concentrates on explaining the VFM approach for the 2015/16. As this is our first year as auditors our VFM risk assessment is ongoing and we report any matters in this regard as the audit progresses and/or in our Report to Those Charged with Governance.



Financial Statements Audit Planning

Our planning work takes place during December 2015 to February 2016. This involves the following key aspects:

- Risk assessment;
- Determining our materiality level; and
- Issuing this audit plan to communicate our audit strategy.

Risk assessment

Professional standards require us to consider two standard risks for all organisations. We are not elaborating on these standard risks in this plan but consider them as a matter of course in our audit and will include any findings arising from our work in our ISA 260 Report. These risks are:

- 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.
- Fraudulent revenue recognition – We do not consider this to be a significant risk for local authorities as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures.

The diagram opposite identifies, significant risks and other areas of audit focus, which we expand on overleaf. The diagram also identifies a range of other areas considered by our audit approach. Areas relating to the Pension Fund are identified by PF.

As this is our first year as auditors our risk assessment will be kept under review and we will report any amendments as the audit progresses and/or in our Report to Those Charged with Governance.



Keys: ● Significant risk ● Other area of audit focus ● Example other areas considered by our approach



Significant Audit Risks

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

Valuation of PPE

Issue:

In 2014/15 the Authority reported Property, Plant and Equipment in its financial statements of £871m. The Authority must exercise judgement in determining the fair value of the different classes of assets held and the methods used to ensure that the carrying values recorded each year reflect those fair values.

Given the materiality in value and the judgement involved in determining the carrying amounts of assets we consider this to be a significant audit risk for 2015/16.

Approach:

We will undertake detailed testing of Property, Plant and Equipment as part of our final accounts audit, including specific detailed testing of the asset valuation. We will critically analyse the valuation methodology adopted by the Authority's valuer and benchmark this against national indices in order to confirm that the valuation is reasonable.

We will consider the basis on which the valuation has been carried out to ensure it is in line with *The Code of Practice on Local Authority Accounting in the United Kingdom 2015-16*. We will carry out detailed testing to ensure that revaluation gains and losses have been correctly reflected in the financial statements.

Valuation of investments – Pension Fund

Issue:

At the 31 March 2015 the Pension Fund had investments of £670 million. The investment portfolio includes private equity and derivatives both of which are complex to value and, in the case of private equity, include a degree of judgement from the Fund Manager. Given the complexity surrounding the investment portfolio we consider this to be a significant audit risk for 2015/16.

Approach:

We will undertake detailed testing of investments as part of our final accounts audit, including assessing the design and operation of controls in place, obtaining independent confirmations from Fund Managers to verify year end balances, undertake substantive testing over sales and purchases made in the year, reviewing year on year movements and comparing performance to known benchmarks and if appropriate engaging our specialist valuation team.



Other areas of audit focus

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

Financial Planning

Issue:

The Authority has significant savings targets to achieve in the coming years. The 15/16 MTFP taken to the February 2015 Council meeting highlighted a funding gap of c.£23 million for 2016/17 and c.£15 million and c.£14 million in 2017/18 and 2018/19 respectively, we are aware that work has been done on identifying savings to address these funding gaps with a balance budget being proposed for 2016/17. In addition the Authority has low general fund reserves of £10 million. These savings need to be achieved in an environment where external funding is decreasing and pressure on service is increasing. The Authority needs to ensure that it has robust financial planning arrangements in place.

Approach:

In conjunction with our VFM work we will critically assess the controls the Authority has in place to ensure a sound financial standing, specifically that its Medium Term Financial Plan has duly taken into consideration the potential funding reductions and that it is sufficiently robust to ensure that the Authority can continue to provide services effectively.

Pension Liability assumptions

Issue:

The Authority is required to provide the value of the pension fund asset/liability as at the reporting date, taking into account numerous and complex assumptions. This creates a risk that the financial statements may be materially misstated.

Small changes to these assumptions can have a large effect on the reported value and the Authority should ensure that the information provided to the actuary is up to date and complete to ensure the values reported in the accounts take into account all requisite information.

Approach:

We will review the instructions provided to the actuary and the information supplied to the Actuary to come to their conclusions. We will also undertake tests of detail on the accounting entries performed as a result of the information returned from the actuary.



Other areas of audit focus

Grant income recognition

Issue:

In 2014/15 the total government grants and contributions recognised was £405 million, and total capital grants deferred was £23.4 million. Accounting for grant income is complex as the basis for revenue recognition in the financial statements will vary depending on the individual conditions associated with each grant. In addition Management must apply judgement to determine if such conditions are attached to a grant and if they have been met.

Approach:

We will perform substantive testing over a sample of revenue and capital grants received during the year. We will review grant correspondence and assess if the Authority has recognised the income in accordance with the CIPFA Code and grant agreement.

Calculation of benefits – Pension Fund

Issue:

The calculation of benefits can be complex. In 2014/15 a total of £32 million was paid out by the fund. Given the quantity and complexity of these calculations there is a risk of misstatement.

Approach:

We will review the process and controls in place over the calculation of benefits to ensure that they are robust. In addition we will perform substantive testing of the calculation of benefits to confirm their accuracy.



Materiality

We are required to plan our audit to determine with reasonable confidence whether or not the financial statements are free from material misstatement. An omission or misstatement is regarded as material if it would reasonably influence the user of financial statements. This therefore involves an assessment of the qualitative and quantitative nature of omissions and misstatements.

Generally, we would not consider differences in opinion in respect of areas of judgement to represent 'misstatements' unless the application of that judgement results in a financial amount falling outside of a range which we consider to be acceptable.

For the Authority, materiality for planning purposes has been set at £6 million for the Authority's standalone accounts, which equates to just over 1 percent of gross expenditure.

For the Pension Fund, materiality for planning purposes has been set at £7 million.

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

Reporting to the Governance, Audit, Risk Management and Standards Committee

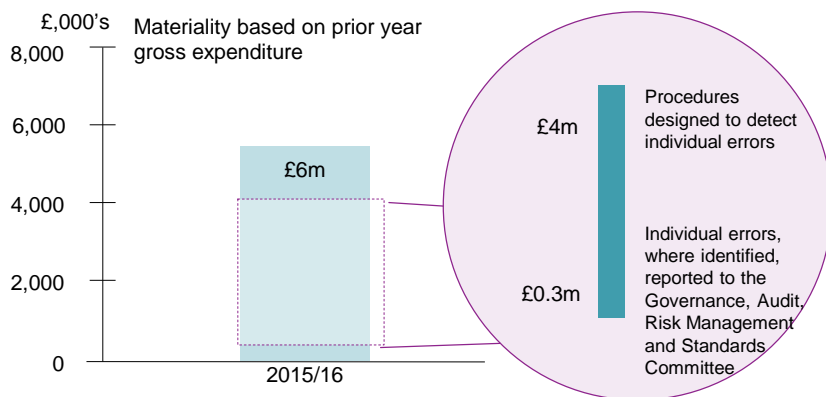
Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Governance, Audit, Risk Management and Standards Committee any unadjusted misstatements of lesser amounts to the extent that these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

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

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 £300,000.

Similarly in the context of the Pension Fund, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £300,000.

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

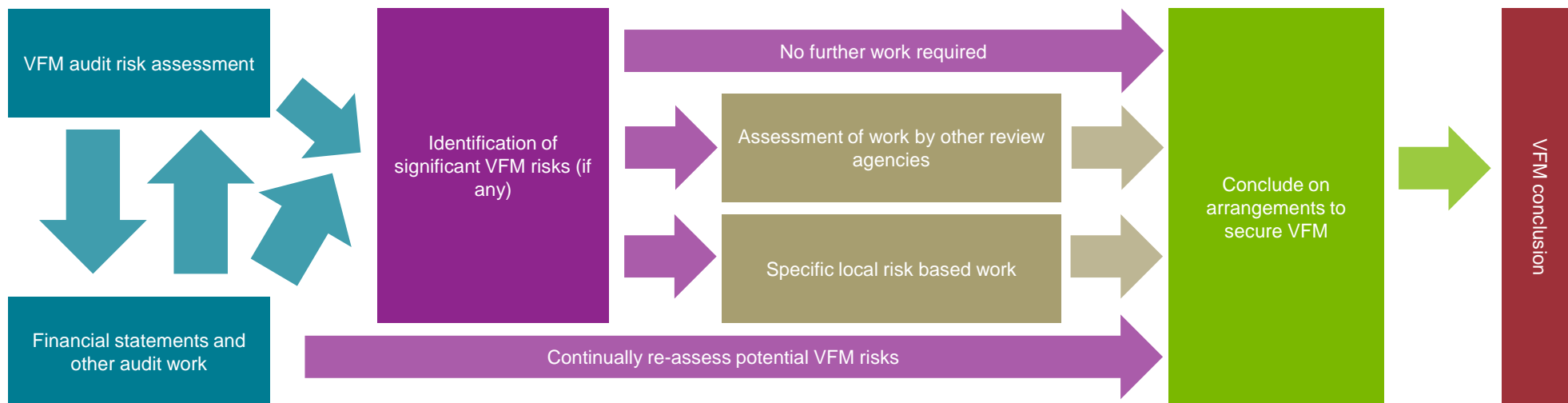
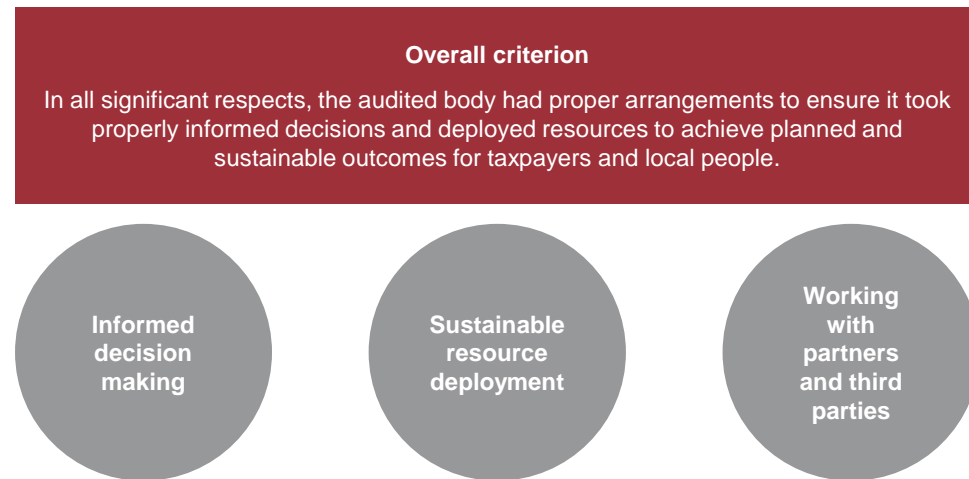


Background to approach to VFM work

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. The diagram to the right shows the details of this criteria.





VFM audit stage	Audit approach
VFM audit risk assessment	<p>We consider the relevance and significance of the potential business risks faced by all local authorities, and other risks that apply specifically to the Authority. These are the significant operational and financial risks in achieving statutory functions and objectives, which are relevant to auditors' responsibilities under the <i>Code of Audit Practice</i>.</p> <p>In doing so we consider:</p> <ul style="list-style-type: none"> ■ The Authority's own assessment of the risks it faces, and its arrangements to manage and address its risks; ■ Information from the Public Sector Auditor Appointments Limited VFM profile tool; ■ Evidence gained from previous audit work, including the response to that work; and ■ The work of other inspectorates and review agencies.
Linkages with financial statements and other audit work	<p>There is a degree of overlap between the work we do as part of the VFM audit and our financial statements audit. For example, our financial statements audit includes an assessment and testing of the Authority's organisational control environment, including the Authority's financial management and governance arrangements, many aspects of which are relevant to our VFM audit responsibilities.</p> <p>We have always sought to avoid duplication of audit effort by integrating our financial statements and VFM work, and this will continue. We will therefore draw upon relevant aspects of our financial statements audit work to inform the VFM audit.</p>
Identification of significant risks	<p>The Code identifies a matter as significant '<i>if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public. Significance has both qualitative and quantitative aspects.</i>'</p> <p>If we identify significant VFM risks, then we will highlight the risk to the Authority and consider the most appropriate audit response in each case, including:</p> <ul style="list-style-type: none"> ■ Considering the results of work by the Authority, inspectorates and other review agencies; and ■ Carrying out local risk-based work to form a view on the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources.



VFM audit stage	Audit approach
<p>Assessment of work by other review agencies</p> <p>and</p> <p>Delivery of local risk based work</p>	<p>Depending on the nature of the significant VFM risk identified, we may be able to draw on the work of other inspectorates, review agencies and other relevant bodies to provide us with the necessary evidence to reach our conclusion on the risk.</p> <p>If such evidence is not available, we will instead need to consider what additional work we will be required to undertake to satisfy ourselves that we have reasonable evidence to support the conclusion that we will draw. Such work may include:</p> <ul style="list-style-type: none"> ■ Meeting with senior managers across the Authority; ■ Review of minutes and internal reports; ■ Examination of financial models for reasonableness, using our own experience and benchmarking data from within and outside the sector.
<p>Concluding on VFM arrangements</p>	<p>At the conclusion of the VFM audit we will consider the results of the work undertaken and assess the assurance obtained against each of the VFM themes regarding the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources.</p> <p>If any issues are identified that may be significant to this assessment, and in particular if there are issues that indicate we may need to consider qualifying our VFM conclusion, we will discuss these with management as soon as possible. Such issues will also be considered more widely as part of KPMG's quality control processes, to help ensure the consistency of auditors' decisions.</p>
<p>Reporting</p>	<p>We will report on the results of the VFM audit through our ISA 260 Report. This will summarise any specific matters arising, and the basis for our overall conclusion.</p> <p>If considered appropriate, we may produce a separate report on the VFM audit, either overall or for any specific reviews that we may undertake.</p> <p>The key output from the work will be the VFM conclusion (i.e. our opinion on the Authority's arrangements for securing VFM), which forms part of our audit report.</p>

Whole of government accounts (WGA)

We are required to review your WGA consolidation and undertake the work specified under the approach that is agreed with HM Treasury and the National Audit Office. Deadlines for production of the pack and the specified approach for 2015/16 have not yet been confirmed.

Elector challenge

The Local Audit and Accountability Act 2014 gives electors certain rights. These are:

- The right to inspect the accounts;
- The right to ask the auditor questions about the accounts; and
- The right to object to the accounts.

As a result of these rights, in particular the right to object to the accounts, we may need to undertake additional work to form our decision on the elector's objection. The additional work could range from a small piece of work where we interview an officer and review evidence to form our decision, to a more detailed piece of work, where we have to interview a range of officers, review significant amounts of evidence and seek legal representations on the issues raised.

The costs incurred in responding to specific questions or objections raised by electors is not part of the fee. This work will be charged in accordance with the PSAA's fee scales.

Our audit team

Our audit team will be led by Andy Sayers and supported by Emma Larcombe and Jessica Hargreaves, and as we are a new audit team for the Authority we will bring a fresh perspective to the accounts. Appendix 2 provides more details on specific roles and contact details of the team.

Reporting and communication

Reporting is a key part of the audit process, not only in communicating the audit findings for the year, but also in ensuring the audit team are accountable to you in addressing the issues identified as part of the audit strategy. Throughout the year we will communicate with you through meetings with the Finance Team and the Governance, Audit, Risk Management and Standards Committee. Our communication outputs are included in Appendix 1.

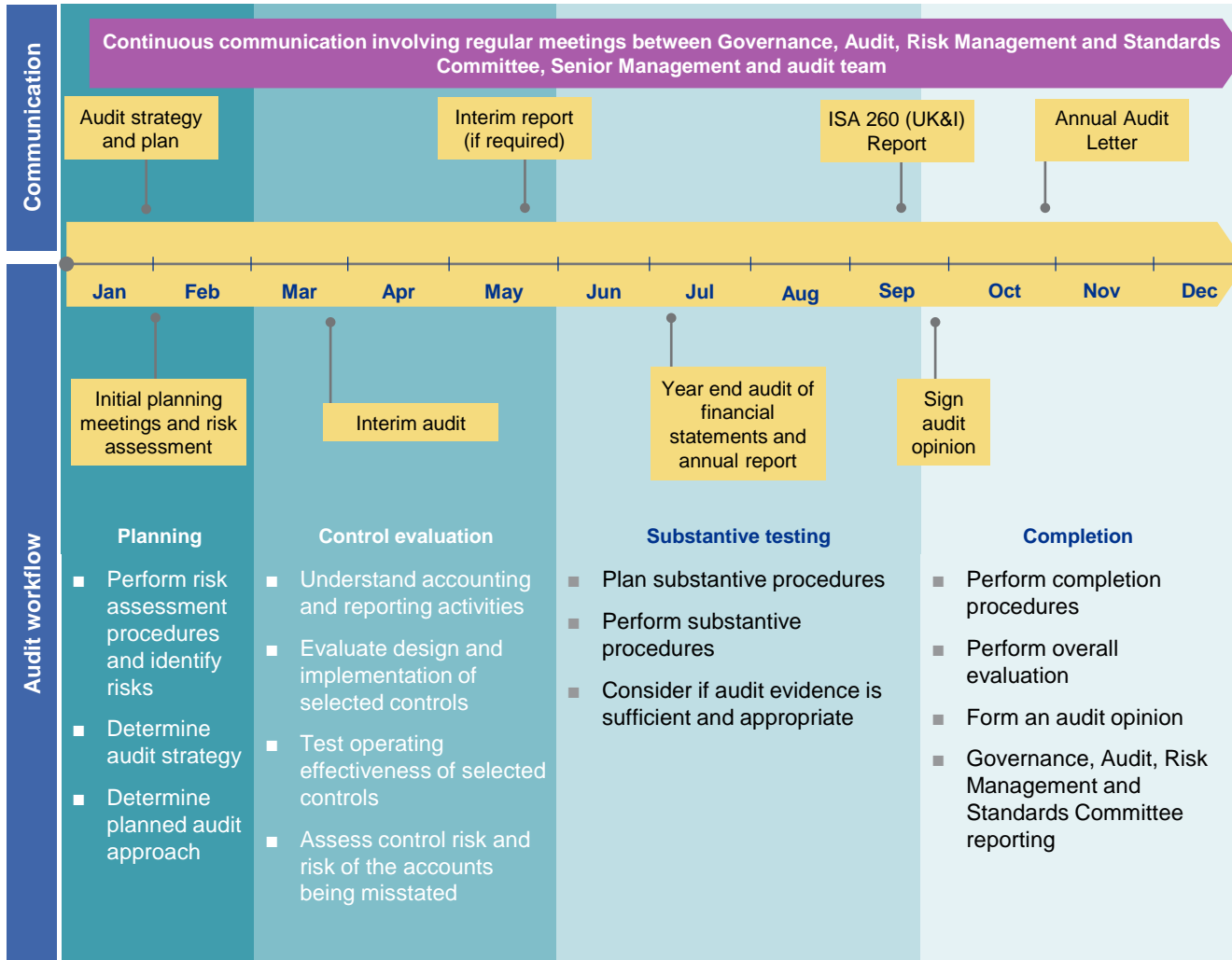
Independence and Objectivity

Auditors are also required to be independent and objective. Appendix 3 provides more details of our confirmation of independence and objectivity.

Audit fee

Our Audit Fee Letter 2015/2016 presented to you in April 2015 first set out our fees for the 2015/2016 audit. This letter also sets out our assumptions. We have not considered it necessary to make any changes to the agreed fees at this stage.

The planned audit fee for 2015/16 is £150,725 for the Authority. The planned audit fee for 2015/16 is £21,000 for the Pension Fund.



Driving more value from the audit through data and analytics

Technology is embedded throughout our audit approach to deliver a high quality audit opinion. Use of Data and Analytics (D&A) to analyse large populations of transactions in order to identify key areas for our audit focus is just one element. We strive to deliver new quality insight into your operations that enhances our and your preparedness and improves your collective 'business intelligence.' Data and Analytics allows us to:

- Obtain greater understanding of your processes, to automatically extract control configurations and to obtain higher levels assurance.
- Focus manual procedures on key areas of risk and on transactional exceptions.
- Identify data patterns and the root cause of issues to increase forward-looking insight.

We anticipate using data and analytics in our work around key areas such as accounts payable and journals. We also expect to provide insights from our analysis of these tranches of data in our reporting to add further value from our audit.



Your audit team has been drawn from our specialist public sector assurance department.



Name	Andy Sayers
Position	Partner
	<p>'My role is to lead our team and ensure the delivery of a high quality, value added external audit opinion.</p> <p>I will be the main point of contact for the Governance, Audit, Risk Management and Standards Committee and the Chief Executive,</p>

Andy Sayers

Partner

Tel: 07802 975 171



Name	Emma Larcombe
Position	Manager
	<p>'I provide quality assurance for the audit work and specifically any technical accounting and risk areas.</p> <p>I will work closely with Andy to ensure we add value.</p> <p>I will liaise with Dawn Calvert and other Executive Directors.'</p>

Emma Larcombe

Manager

Tel: 07920 257 310



Name	Jessica Hargreaves
Position	Assistant Manager
	<p>'I will be responsible for the on-site delivery of our work and will supervise the work of our audit assistants.'</p>

Jessica Hargreaves

Assistant Manager

Tel: 07468 740 813

Independence and objectivity

Professional standards require auditors to communicate to those charged with governance, at least annually, all relationships that may bear on the firm's independence and the objectivity of the audit engagement partner and audit staff. The standards also place requirements on auditors in relation to integrity, objectivity and independence.

The standards define 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case this is the Governance, Audit, Risk Management and Standards Committee.

KPMG LLP is committed to being and being seen to be independent. APB Ethical Standard 1 Integrity, Objectivity and Independence requires us to communicate to you in writing all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Engagement Lead and the audit team.

Further to this auditors are required by the National Audit Office's Code of Audit Practice to:

- Carry out their work with integrity, independence and objectivity;
- Be transparent and report publicly as required;
- Be professional and proportional in conducting work;
- Be mindful of the activities of inspectorates to prevent duplication;
- Take a constructive and positive approach to their work;
- Comply with data security and other relevant requirements relating to the security, transfer, holding, disclosure and disposal of information.

PSAA's Terms of Appointment includes several references to arrangements designed to support and reinforce the requirements relating to independence, which auditors must comply with. These are as follows:

- Auditors and senior members of their staff who are directly involved in the management, supervision or delivery of PSAA audit work should not take part in political activity.

- No member or employee of the firm should accept or hold an appointment as a member of an audited body whose auditor is, or is proposed to be, from the same firm. In addition, no member or employee of the firm should accept or hold such appointments at related bodies, such as those linked to the audited body through a strategic partnership.
- Audit staff are expected not to accept appointments as Governors at certain types of schools within the local authority.
- Auditors and their staff should not be employed in any capacity (whether paid or unpaid) by an audited body or other organisation providing services to an audited body whilst being employed by the firm.
- Auditors appointed by the PSAA should not accept engagements which involve commenting on the performance of other PSAA auditors on PSAA work without first consulting PSAA.
- Auditors are expected to comply with the Terms of Appointment policy for the Engagement Lead to be changed on a periodic basis.
- Audit suppliers are required to obtain the PSAA's written approval prior to changing any Engagement Lead in respect of each audited body.
- Certain other staff changes or appointments require positive action to be taken by Firms as set out in the Terms of Appointment.

Confirmation statement

We confirm that as of January 2016 in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Engagement Lead and audit team is not impaired.



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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. We draw your attention to the Statement of Responsibilities of auditors and audited bodies, which is available on Public Sector Audit Appointment'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 Andy Sayers the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers, by email to 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 3HZ.