External Audit Report 2017/18

London Borough of Harrow

—

July 2018

Content

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This report is addressed to the London Borough of Harrow (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, you should contact Andrew Sayers, the engagement lead to the Authority and the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, who will try to resolve your complaint. After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

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 Harrow (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 Governance, Audit, Risk Management and Standards (GARMS) 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 GARMS Committee meeting. The following work is ongoing:

- Financial statements audit:
  - Property, Plant and Equipment – revaluations and reclassification of assets under construction;
  - Cash – RBS loan confirmations;
  - Pensions (Council) – completion of data work programmes and consideration of the actuary's report;
  - Payroll – detailed analytical procedure and payroll reconciliation;
  - Pension Fund – investments (review of custodian/investment manager controls reports; and testing all level 3 and a sample of level 1 investments); and investment management expenses; and
- Completion and review steps.

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 for the deadline of 31 July 2018, following the GARMS Committee adopting them and receipt of the management representations letter.

We also anticipate issuing an unqualified audit opinion in relation to the Pension Fund's financial statements for the deadline of 31 July 2018.

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 to date are:

- There are no unadjusted audit differences.
- We agreed presentational changes to the accounts with Finance, mainly related to compliance with the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.
- At this stage we do not expect to request any specific representation in addition to our routine requests for management representations.
- We reviewed the narrative report and have no matters to raise with you.
- We did not receive any queries or objections from local electors this year.

We anticipate issuing our completion certificate by 31 July 2018. We also intend to issue our 2017/18 Annual Audit Letter by 31 August 2018. The audit cannot be formally concluded and an audit certificate issued as we will not have completed our Whole of Government Accounts (WGA) work. The deadline for completion of the WGA is 31 August 2018.

We will update the committee orally on any matters arising as we progress our work in advance of the Committee meeting.

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 for the deadline of 31 July 2018.

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.).

We have a duty to consider whether to issue a report in the public interest about something we believe the Authority should consider, or if the public should know about.

We have not identified any matters that would require us to issue a public interest report. In addition, we have not had to exercise any other audit powers under the Local Audit & Accountability Act 2014.

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 2017/18 financial statements.

We understand that the Authority has addressed the recommendations raised in our ISA260 report in 2016/17, see appendix 1. Our work to date has not identified any new recommendations.

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

- Teachers’ Pensions Return: we plan to undertake this work in September/October 2018, to meet the deadline of 30 November 2018; and
- Pooling of Capital Receipts Return: we plan to undertake this work in September/October 2018, to meet the deadline of 30 November 2018.

The fees for this work is explained in appendix 2.

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 2017/18 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 have not made any recommendations. 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 Interim Technical Accounting Manager 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.

Financial statements audit

4. Accounting standards	We work with you to understand changes to accounting standards and other technical issues. For 2017/18 these changes related to: • Amendments to Business Improvement District Schemes, Business Rate Supplements, and Community Infrastructure Levy for the Community Infrastructure Levy to clarify the treatment of revenue costs and any charges received before the commencement date – not considered to have a significant impact for the Authority; • amendment to Narrative Reporting to introduce key reporting principles for the Narrative Report – clarifying what should be included, not considered significant for the Authority; • updates to Presentation of Financial Statements to clarify the reporting requirements for accounting policies and going concern reporting – increases the visibility of going concern for example in the responsibilities statement; and • amendments to Accounting and Reporting by Pension Funds to require a new disclosure of investment management transaction costs and clarification on the approach to investment concentration disclosure – increased disclosure of costs, but not considered significant.
5. Accounts Production	We received complete draft accounts by 31 May 2018 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 2017/18. The Authority incorporated measures into its closedown plan to manage this complex process. The Authority recognised the additional pressures which the earlier closedown brought and we engaged with officers in the period leading up to yearend to proactively address issues as they emerge. We consider that the overall process for the preparation of your financial statements is appropriate. We consider the Authority's accounting practices to be appropriate. We thank 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 work to date we identified only presentational issues which have been adjusted as they have no material effect on the financial statements.
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 11 July 2018. 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 asking Management to provide any specific 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 2017/18 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 land and buildings and pension liabilities 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

Authority significant audit risks

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

SIGNIFICANT audit risk	Account balances affected	Summary of findings
Valuation of land and buildings	Council Dwellings, £436,087k, PY £440,423k; Other Land and Buildings, £514,248k, PY £460,306k	The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Authority has adopted a rolling revaluation model which sees land and buildings revalued over a five year cycle. As a result individual assets may not be revalued for four years. This creates a risk that the carrying value of those assets not revalued in year differs materially from the year end fair value. In addition, as the valuation is undertaken as at 1 April, there is a risk that the fair value is different at year end. We reviewed the approach that the Authority adopted to assess the risk that assets not subject to valuation were materially misstated and considered the robustness of that approach. In addition, we considered movements in market indices between revaluation dates and the year end in order to determine whether these indicate that fair values had moved materially over that time. In relation to those assets which have been revalued during the year we reviewed the accounting entries made to record the results of the revaluation in order to ensure that they were appropriate. We also assessed the valuer's qualifications, objectivity and independence to carry out such valuations and reviewed the methodology used (including testing the underlying data and assumptions). Some elements of this work are still to be completed, but as a result of the work completed so far we have no issues arising to bring to your attention relating to the valuation of land and buildings as disclosed in the financial statements. We have set out our view of the assumptions used in relation to accounting for Property, Plant & Equipment at page 16.

Financial statements audit

SIGNIFICANT audit risk	Account balances affected	Summary of findings
Pension assets and liabilities	Pensions Liability and Pensions Reserve, both £355,291k, PY £369,458k	The net pension liability represents a material element of the Authority's balance sheet. The Authority is an admitted body of the London Borough of Harrow Pension Fund, which had its last triennial valuation completed as at 31 March 2016. This forms an integral basis of the valuation as at 31 March 2018. Valuation of the Local Government Pension Scheme relies on assumptions, most notably actuarial assumptions, and actuarial methodology which results in the Authority's overall valuation. There are financial assumptions and demographic assumptions used in the calculation of the Authority's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should reflect the profile of the Authority's employees and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, and updated to reflect any changes. There is a risk that the assumptions and methodology used in the valuation of the Authority's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements. As part of our work we reviewed the controls that the Authority has in place over the information sent to the Scheme Actuary, including the Authority's process and controls with respect to the assumptions used in the valuation. We also evaluated the competency, objectivity and independence of Hymans Robertson. We reviewed the appropriateness of the key assumptions included within the valuation and compared them to expected ranges. We also reviewed the methodology applied in the valuation by Hymans Robertson. In addition, we reviewed the overall Actuarial valuation and considered the disclosure implications in the financial statements. As a result of this work we determined that pension assets and liabilities movements and year end balances were reflected correctly in the financial statements. We have set out our view of the assumptions used in valuing pension assets and liabilities at page 16.

Financial statements audit

Authority 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.

Other areas of audit focus	Account balances affected	Summary of findings
Faster close	No specific balances identified	In prior years, the Authority has been required to prepare draft financial statements by 30 June and then final signed accounts by 30 September. For years ending on and after 31 March 2018 revised deadlines apply which require draft accounts by 31 May and final signed accounts by 31 July. During 2016/17, the Authority started to prepare for these revised deadlines and advanced its accounts production timetable so that draft accounts were ready by 16 June 2017 (accounts were signed on 29 September 2017). Whilst this was an advancement on the timetable applied in preceding years, further work was still required in order to ensure that the statutory deadlines for 2017/18 would be met. We liaised with officers in preparation for our audit in order to understand the steps that the Authority was taking in order to ensure it met the revised deadlines. We also advanced audit work into the interim visit in order to streamline the year end audit work. We received draft financial statements on the statutory deadline of 31 May 2018. The quality of this draft was consistent with that of prior years, and to date we have only identified relatively minor presentational matters that we understand will be amended in the financial statements. As a result of this work we determined that the Authority has managed the faster close requirements effectively with no significant impact on the quality of the financial statements presented for audit.

Financial statements audit

Authority other areas of audit focus (continued)

Other areas of audit focus	Account balances effected	Summary of findings
Regeneration programme	Assets Under Construction, £103,570k, PY £85,804k	The regeneration programme is part of the Authority's 'Building a better Harrow' regeneration strategy, which lays out plans for £1.75 billion investment in the Borough in the period 2014-26. Work has begun with some phases/elements completed and others in various design phases and therefore capital costs are continuing to be incurred in relation to the regeneration programme. The Authority will continue to exercise judgement in determining the fair value of assets under construction and the methods used to ensure that the carrying values recorded each year reflect those fair values. We have undertaken detailed testing of assets under construction and any movements within this category, as part of our final accounts audit. Some elements of this work are still to be completed, but as a result of the work completed so far we have no issues arising to bring to your attention regarding assets under construction, related to the regeneration programme (movements and year end balance) as disclosed in the financial statements.
Grant income recognition	CIL reserve – Harrow, £5,886k, PY £6,133k Capital grants receipts in advance £5,594k, PY £3,523k Capital grants and contributions unapplied £27,538k, PY £19,568k	In 2016/17 the Authority received total capital grants of £32 million. Also as at 31 March 2017 the Authority had three relevant balances to this area: a CIL reserve (£6.1 million); capital grants received in advance (£3.5 million) and capital grants and contributions unapplied (£19.6 million). Accounting for capital grant income and ensuring balances remain appropriate is complex as the basis for 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. We have performed substantive testing over a sample of capital grants received during the year and balances held at the 31 March 2018. We have reviewed grant correspondence and assessed if the Authority has recognised the income in accordance with the CIPFA Code and grant agreement. Some elements of this work are still to be completed, but as a result of the work completed so far we have no issues arising to bring to your attention relating to the capital grants and contributions received in the year and the balances held at the year end as disclosed in the financial statements.

Financial statements audit

Pension Fund significant audit risks

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

SIGNIFICANT audit risk	Account balances effected	Summary of findings
Valuation of hard to price investments	Private equity, £13,844k, PY £19,341k Pooled Investments – property funds, £67,656k, PY £64,409k (moved from level 1 in 2016/17, to level 3 in 2017/18 due to additional information regarding pricing and valuations)	The Pension Fund invests in a wide range of assets and investment funds, some of which are inherently harder to value or do not have publicly available quoted prices, requiring professional judgement or assumptions to be made at year end. The pricing of complex investment assets may be susceptible to pricing variances given the assumptions underlying the valuation. In the prior year financial statements £19 million out of a total of £777 million investments, or 2.4%, were in this harder to price category. Due to additional information and a re-categorisation the value of these harder to value investments has increased to £81.5 million out of a total of £811m, or 10.0%. As part of our audit of the Pension Fund, we independently verified a selection of investment asset prices to third party information and obtained independent confirmation on asset existence. We also tested the extent to which the Pension Fund had challenged the valuations reported by investment managers for harder to price investments and obtained independent assessment of the figures. The work on this is in progress at present.

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.

Other areas of audit focus	Account balances effected	Summary of findings
Calculation of benefits	Pensions, £27,816k, PY £27,044k; Commutation and lump sums, £4,631k, PY £4,074k; and Lump sum death benefits, £827k, PY £671k	The calculation of benefits can be complex. In 2016/17 a total of £32 million was paid out by the Pension Fund (pensions and lump sums). Given the quantity and complexity of these calculations there is a risk of misstatement. We completed detailed sample testing over benefits paid and completed a substantive analytical review over the total benefits paid in year. As a result of this work we determined that the testing of benefits has not identified any issues.

Financial statements audit

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 conditional grant income (capital grants received in 2017/18 were £22 million; and as at 31 March 2018 the Authority held a Community Infrastructure Levy (CIL) reserve of £5.9 million; and a capital grants unapplied reserve of £27.5 million. We therefore combined this work with the other area of focus for grant income recognition.	For the results of our work see 'grant income recognition' work above, in 'other areas of audit focus'.
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.	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 (£m)**	**KPMG comment**
Provisions	2	2	£10.3 million (PY:£10.1 million)	Our final accounts audit approach focused on the completeness of identified provisions and the reasonableness of the total balance. We performed substantive testing over the Insurance provisions balance (totalling £7.3m) confirming the accuracy of the calculation and methodology used. Our audit work has given us sufficient reasonable assurance that the provisions stated in the financial statements are materially accurate.
Accruals	3	3	£15.3 million (PY:£10 million)	Our procedures focused on considering the nature of accruals, selected on a sample basis, and whether the Authority has calculated the accrual using relevant supporting documentation. In addition we have undertaken a retrospective review of accruals made in 2016/17 and agreed them to subsequent cash payments made in 2017/18. Our final accounts audit procedures did not identify any adjustments to this balance. We are satisfied that the accruals made in 2016/17 were reasonable and in line with actual payments made. Accruals have increased significantly this year, but are less than the £17m at 31 March 2015.

Financial statements audit

Assessment of subjective areas				
Asset / liability class	**Current year**	**Prior year**	**Balance (£m)**	**KPMG comment**
PPE: HRA assets	TBC	Pre adjustment 4 Post adjustment 2	£436.1 million (PY:£440.4 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 an internal expert to provide valuation estimates. We reviewed instructions provided and deem that the valuation exercise is in line with the instructions. The Authority valuation takes place at 1 April and an uplift is then applied for the period to 31 March. From the work completed to date, we have not identified any concerns relating to the valuation of HRA assets.
PPE: assets under construction	TBC	2	£103.6 million (PY:£85.8 million)	We have reviewed and tested the year end assets under construction balance, and in-year movements. From the work completed to date, we have not identified any concerns relating to the valuation, movements and presentation of assets under construction.
Debtors provisioning	3	3	£18.1m (PY:£17 million)	Our audit procedures considered the reasonableness of the methodology applied by the Authority in calculating this figure. We performed substantive testing over the Housing Benefits and Authority tax provisions (totalling £12.6m) to ensure the reasonableness and accuracy of these calculations. Our testing did not identify any concerns over these provisions.
Pension liability	3	3	£355.3 million (PY:£369.5 million)	The Authority continues to use Hymans Robertson to provide actuarial valuations in relation to the assets and liabilities recognised as a result of participation in the Local Government Pension Scheme. Due to the overall value of the pension assets and liabilities, small movements in the assumptions can have a significant impact on the overall valuation. For example, a 0.5% change in the discount rate would change the net liability by £100 million. The actual assumptions adopted by the actuary fell within our expected ranges and we are satisfied with the reasonableness of the actuarial valuation and its reflection in the year end accounts.

Financial statements audit

Annual Governance Statement and Narrative Report of the Authority

We have reviewed the Authority’s Narrative Report and Annual Governance Statement and have confirmed that they are consistent with the financial statements and our understanding of the Authority.

Pension fund audit

The audit of the pension fund 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 Harrow’s financial statements. We confirm that the Fund’s financial statements are consistent with the pension fund financial statements included in the accounts of the London Borough of Harrow. We read the information in the Fund’s Annual Report to identify material inconsistencies with the Fund’s financial statements. We can confirm it is not inconsistent with the financial information contained in the audited financial statements. As such we anticipate issuing an unqualified consistency opinion on the pension fund financial statements.

Queries from local electors

We did not receive any questions or objections from members of the public this year.

Financial statements audit

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 has recently issued its guidance for completing the WGA and issued the consolidation packs that authorities need to complete. The deadline for the audit is 31 August 2018. We aim to complete the work in August 2018.

We have not received any objections to the accounts from local electors, therefore we expect to issue our audit certificate in August 2018 following completion of the WGA work.

Whole of Government Accounts (WGA)

We have not yet reviewed your WGA consolidation pack and anticipate completing the work required in August 2018.

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:

- Teachers' Pensions Return: we plan to undertake this work in September/October 2018, to meet the deadline of 30 November 2018; and
- Pooling of Capital Receipts Return: we plan to undertake this work in September/October 2018, to meet the deadline of 30 November 2018.

Audit fees

Our fee for the audit was £150,724 excluding VAT (£150,724 excluding VAT in 2016/17). Our fee for the audit of the Pension Fund was £21,000 excluding VAT (£21,000 excluding VAT in 2016/17). These fees were in line with that highlighted in our audit plan approved by the GARMS Committee in January 2018.

Our work on the certification of Housing Benefits (BEN01) is planned for August and September 2018. The planned scale fee for this is £27,735 excluding VAT (£20,423 excluding VAT in 2016/17). Planned fees for other grants and claims which do not fall under the PSAA arrangements is £7,000 excluding VAT (£7,000 excluding VAT in 2016/17).

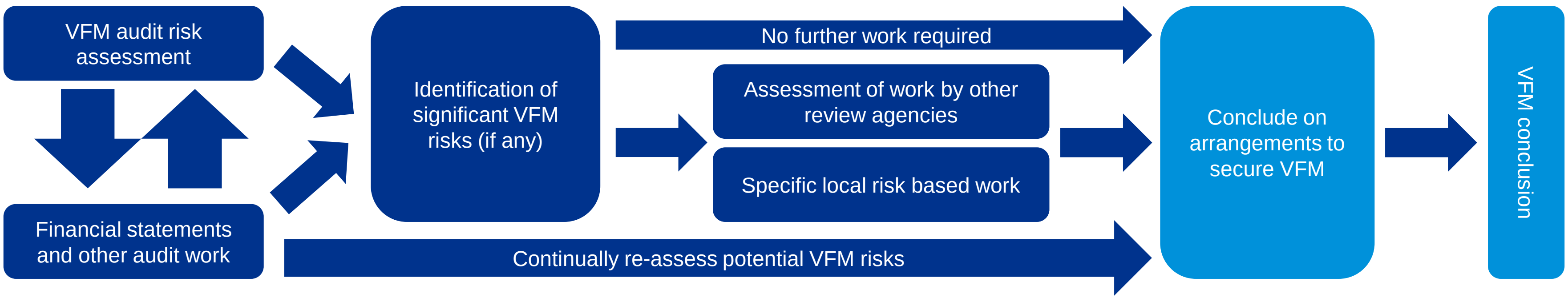
We have not completed any other non-audit work at the Authority in year.

Value for money

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.'

We follow a risk based approach to target audit effort on the areas of greatest audit risk as summarised below:



We identified one significant VFM risk which is reported overleaf. 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 2018, based upon the criteria of informed decision making, sustainable resource deployment and working with partners and third parties.

Value for money

Significant risk based VFM audit work

Below we set out the detailed findings of our significant risk based VFM work. This work was completed to address the residual risks remaining after our assessment of the higher level controls in place to address the VFM risks identified in our planning and financial statements audit work.

Significant VFM risk	Why this risk is significant	Our audit response and findings
Delivery of Medium Term Financial Strategy (MTFS)	The Authority's balanced budget for 2017/18, includes the delivery of £10 million of approved savings plans. Any shortfall or delay in delivery of savings increases the already challenging financial pressures on the Authority even further and may mean reducing the already low (comparatively) level of general reserves and will increase the level of savings needed in future years. The Authority's December 2017 MTFS included a balanced draft budget for 2018/19 with a further £11 million of savings plans included. The MTFS identified further planned savings totalling £4.4 million across 2019/20 and 2020/21, leaving a budget gap of £28 million to be addressed. The significant size of the future budget gap reflects the continuing constraints on resources; service cost and demand pressures; and the one-off nature of some elements used by the Authority to get to a balanced budget for 2018/19. The delivery of the planned savings (and identification of further additional savings) is critical to ensure the Authority's financial resilience is maintained. Consequently, the Authority will need to continue to manage its savings plans to secure longer term financial and operational sustainability.	Our work in response to this risk has focused on: savings identification, monitoring and reporting; levels of reserves; 2017/18 out-turn; 2018/19 budget; and MTFS. **Savings identification, monitoring and reporting** *Identification* We have reviewed the process that is in place for the identification of savings. Each Directorate are given savings targets to achieve each year and it their responsibility to identify the savings to be made. Savings are scrutinised and challenged by the relevant Directorate Commission Panel which is made up of Members and chaired by the relevant portfolio holder. To enable choice and flexibility more savings than are required are presented to the Panel. Only once the Commissioning panel have reviewed, scrutinised and approved the saving is it added to the MTFS. *Monitoring* We reviewed a sample of 9 savings identified and monitored their progress through the financial year. This included having discussions with the relevant Director and Finance Manager for each area the savings related to and how they approach and review the savings process. Discussions with the Directors identified that there was a strong awareness of the need to identify and deliver savings within an environment that was proving challenging in some areas such as strong demand and delays to related project timelines. Of the 9 savings we reviewed, the Council had identified that three would not be achieved and one which would only be achieved partially. In all of these cases mitigations had been identified by the Authority to address these savings gaps.

Value for money

Our response and findings

Of the £10.241 million of savings for 2017/18, £7.349 million has been achieved ie 72%; and consequently, £2.892 million has been confirmed as not achieved. Although this represents a potentially significant shortfall, the Council was on track for most of the year to deliver the balanced budget and indeed to deliver an under spend. For the later part of the year (at least the final quarter) this was expected to be around £3 million, due to mitigating actions taken early in the financial year.

The main drivers and mitigating actions for this position (in spite of the savings not achieved) was additional grant income allocated to the Council after the budget had been set (but keeping it centrally, due to the Council's financial position and the need to improve reserves position); imposition of a spending freeze for certain areas; and contingencies that were not being drawn upon through-out the year.

We have also considered the £2.286 million of savings categorised as red which means they were not achieved in 2017/18. Some of these savings are red as the implementation was delayed and, although not achieved in 2017/18, will be progressed in 2018/19. Others relate to savings which have been reversed out as part of the 2018/19 budget setting process which in the Council's view will reduce the risk of non-achievement of savings plans in 2018/19. Details have been set out in the June 2018 Cabinet report.

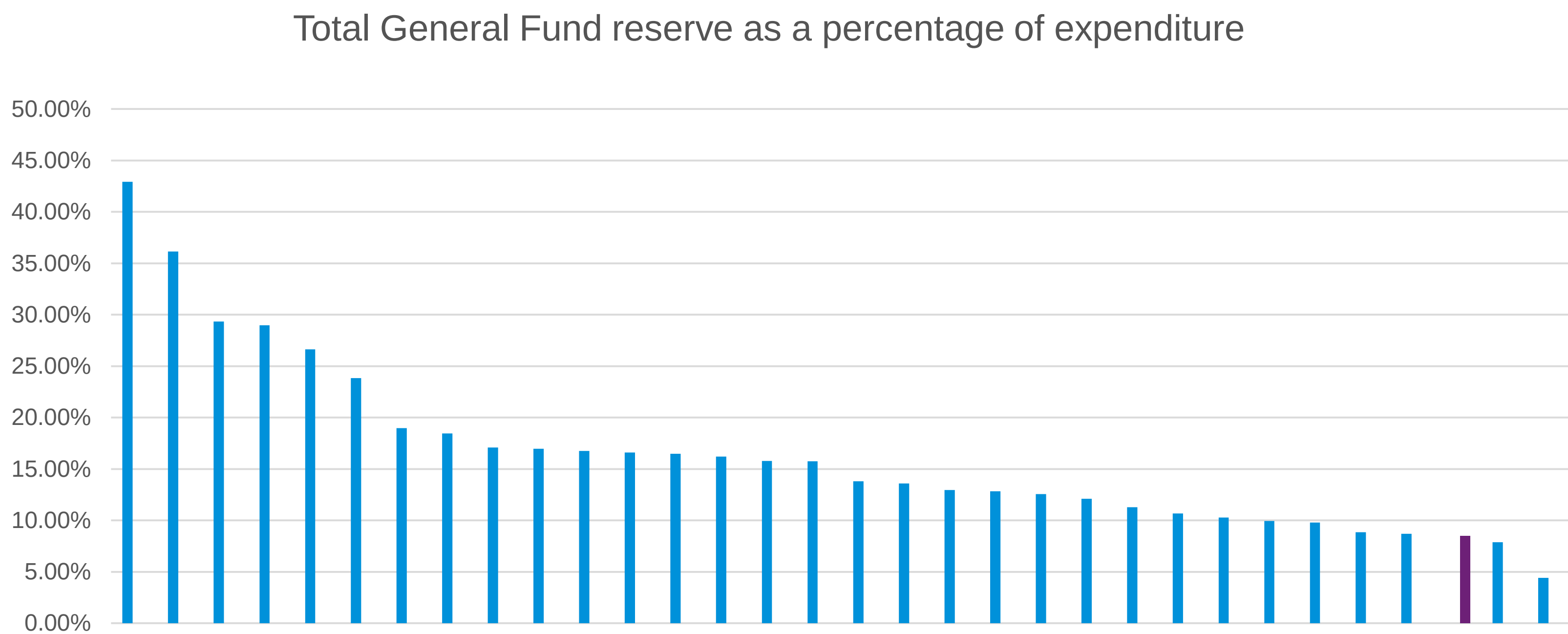
The total savings required for 2018/19 is £9.179 million. As at period 2 (end of May) - 75% (£6.899 million) of the 2018/19 savings are considered to be on track to be achieved (Green). 15% (£1.332 million) are rated as amber (saving only partially achieved or risks remaining). We have reviewed the commentary for the 6 schemes classified as amber. The commentary for each sets out that while there are risks or some small delays (1 or 2 months), the relevant Directorate is managing the shortfall through alternatives within the Directorate, or they are being cautious about implementing new ways of working. The red savings of £0.948 million are considered to not be achievable. However the commentary for most is clear that the shortfall will be negated through alternative/mitigating actions within the respective Directorate, including being off-set by underspends elsewhere; across internally provided services within Adults; additional income; and maximisation of capacity at Neighbourhood Resource Centres enabling externally funded placements to be supported through in house provision.

The Council's analysis shows that the expected shortfall (after taking account of mitigations etc) is projected to be £0.218 million, or 2.4% of the overall savings programme. This is a position that is expected to be manageable for the Council in spite of the low reserves. Also the Director of Finance is very clear that the Council will continue in its endeavours to deliver a comparatively significant overall under spend for 2018/19 to enable it to better support the following two years, which are still challenging in terms of the 'gaps' that need to be addressed.

Level of reserves

We have considered the Authority's level of reserves. While we note they are low compared to other London Borough's (as depicted overleaf), the low level of reserves is within the Authority's financial plan and is a conscious decision. At the end of 2016/17 the General Fund Reserve balance was £10 million, and this was maintained for 2017/18. As the reserves balance did not move in year this demonstrates that the Authority was able to achieve its year end position without the use of its General Fund reserves, albeit advantage was taken of the capital receipts flexibility available and some one-off actions. In addition we have noted that the Council has been able to increase its available reserve balance due to the under spend, to a total value of £41.7 million at 31 March 2018 (£38.5 million in 2016/17). The earmarked reserves also include amounts to help Fund savings initiatives.

Value for money



The graph above shows the total general Fund reserves for all London boroughs as a percentage of total expenditure. This shows that whilst not the lowest reserve balance Harrow's reserves (shown in purple) are at the bottom of the range of reserve balances.

We note that as London Boroughs vary how they manage reserves the above is indicative only.

Value for money

Our response and findings

2017/18 Outturn

The out-turn report for 2017/18 shows that in overall terms the Council has delivered an under spend of £3.2 million that will be used to support the 2018/19 budget (as a central contingency - £2 million) and £1.2 million to support capacity in the delivery of the MTFS. Key to the above outcome has been:

- Introducing a spending freeze across the Council to ensure savings are not lost due to over spending. Saving an estimated £1.5m.
- All additional one-off income or savings being held centrally and not distributed back to the departments directly. Those unused are carried forward as part of the underspend noted above.
- Delivery of the savings programme amounting to £7.35m (72% of the overall programme, see earlier commentary).

The out-turn report considered by Cabinet in June 2018 details what has not been achieved and why, demonstrating that the Council is aiming to be transparent and trying to ensure it learns to be able to identify and deliver savings better in future.

2018/19

The Authority's 2018/19 budget was approved by Cabinet in February 2018. The Authority has set a savings target of £9.2 million and we have commented on the position reported as at the end of Month 2 (May 2018) earlier.

The Director of Finance is clear that the additional controls introduced in 2017/18 will remain in place for 2018/19 given the continuing budget pressures. These include:

- Continuing the spending freeze across the Council to ensure savings are not lost due to over spending, but for 2018/19 being clear with Directorates that spending pressures need to be dealt with in the Directorate as there was no corporate funding support available.
- The Council had agreed that all of the growth agreed for 2017/18 must be reversed out over 2019/20 and 2020/21 (around £10 million).
- Continuing recruitment controls whereby all recruitment needs to be signed off by the Director of Finance and the Chief Executive.
- All additional one-off income or savings will continue to be kept centrally.

The Council's initial budget monitoring for 2018/19 (to end of May 2018) has highlighted a potential year-end overspend of £1.7 million, which is primarily contained within Adults' Services. The Council expects that the over spend will be managed (along with other pressures as they arise/become known) through the above actions and controls that are in place in a similar approach to that employed successfully in 2017/18.

MTFS

In response to the financial challenges faced, the Council has set a three year MTFS covering the period 2018/19 to 2020/21.

Over the four year period 2015/16 to 2018/19, the Council estimated that it needed to fund an £83m budget gap in order to achieve a balanced budget. If this four year period is extended to the end of the current MTFS (2020/21) the Council now estimates that it has had/will have to fund £125m of pressures in order to achieve a balanced budget.

Value for money

Our response and findings

To set this figure into context, the Council does not have large cash reserves. Its general fund balances stand at £10m and remain within the lower quartile when benchmarked with other local authorities in London. The Council is also clear that spending the GF reserves is not a responsible way to offset lost revenue.

The gross Directorate budget for 2018/19 is £551 million. A significant proportion of this funding is ring fenced for services such as housing benefit, schools and public health. The Council's net controllable budget is £168.9 million in 2018/19 and this is the element of the budget that the Council can exercise more control over and from where savings must be found. The direct departmental spend of £144.5 million (which excludes corporate items such as capital financing costs and contingencies).

The latest MTFS (February 2018) achieves a balanced budget position for 2018/19 and has identified budgets gaps of £17.6 million and £16.1 million for 2019/20 and 2020/21 respectively. The MTFS also notes that it includes a number of assumptions in relation to grant settlements, council tax income, legislation and demographics.

Following the budget and MTFS approval the Council has continued to work on progressing plans to balance the MTFS for 2019/20 and 2020/21. At present the Council considers that it can address around £15.6 million of the £17.6 million gap for 2019/20 through a combination of one-off funds/resources available; the maximum non-ring-fenced increase in Council Tax (2.99%); and savings identified by Directorates to date. This leaves a remaining £2 million to be found. The Council will undertake further exercises and 'star chambers' through July and August with the aim of having plans in place by September to enable Members to agree the budget for 2019/20 by the end of October 2018.

Conclusion

The Authority has a number of challenges in order to continue to achieve a balance budget going forward. We consider the arrangements that the Authority has put in place to ensure that savings are identified, monitored and reported to be appropriate and the increased spending controls in 2017/18 were successful in enabling it to build up a reserve to assist in meeting known challenges for 2018/19 onwards. Members and Officers are aware of the challenges facing the Authority and are invested in achieving savings and looking for new ways of working and income streams.

Overall the MTFs has been built on robust assumptions which we have agreed to supporting documents. Given the Council's limited reserves the need to explore other income sources such as through the regeneration, commercialisation projects need to be driven forward however caution should be taken over ensuring that returns on these projects are not over promised and focus is taken away from identifying savings. For this reason the Council has taken such savings out of its plans and these are no longer included in the budget/savings for 2018/19 onwards (thus if they do deliver savings or additional resources these will be a welcome bonus).

A further point is that the Council has not included any potential benefits that are expected to be derived from the London wide business rates retention scheme agreed with the Government for 2018/19.

Recommendations raised and followed up

Recommendations raised as a result of our work in the current year are as follows:

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

We have not identified any recommendations to date for the current year.

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):
7	7	0

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 2017/18, presented to you in January 2018.

Materiality for the Authority's accounts was set at £8 million which equates to around 1.3% of gross expenditure.

Materiality for the Pension Fund was set at £10 million which equates to around 1.2% of gross assets.

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

Reporting to GARMS 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 GARMS Committee any misstatements of lesser amounts to the extent that these are identified by our audit work. Under *ISA 260*, we are obliged to report omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. *ISA 260* defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria. *ISA 450* requires us to request that uncorrected misstatements are corrected.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £400,000 for the Authority and less than £500,000 for the Pension Fund.

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

Audit differences

Unadjusted audit differences

Under UK auditing standards (ISA (UK&I) 260) we are required to provide the GARMS 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 GARMS Committee, details of all adjustments greater than £400,000 (£500,000 for the Pension Fund) will be reported.

Based on the work completed to date there are no unadjusted audit differences that need to be reported to the GARMS Committee.

Adjusted audit differences

To assist the GARMS Committee in fulfilling its governance responsibilities we present a summary of any significant adjusted audit differences (including disclosures) identified during the course of our audit.

Based on the work completed to date there are no adjusted audit differences that need to be reported to the GARMS Committee.

Presentational adjustments

We identified presentational adjustments required to ensure that the Authority’s (and Pension Fund’s) financial statements for the year ending 31 March 2018 are fully compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2017-18 (‘the Code’). To date none of these adjustments have been considered to be significant.

Appendix 4

Audit independence

ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF THE LONDON BOROUGH OF HARROW

Professional ethical standards require us to provide to you at the conclusion of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP’s objectivity and independence, the threats to KPMG LLP’s independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP’s objectivity and independence to be assessed.

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code of Audit Practice, the provisions of Public Sector Audit Appointments Limited’s (‘PSAA’s’) Terms of Appointment relating to independence, the requirements of the FRC Ethical Standard and the requirements of Auditor Guidance Note 1 - General Guidance Supporting Local Audit (AGN01) issued by the National Audit Office (‘NAO’) on behalf of the Comptroller and Auditor General.

This Statement is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses: general procedures to safeguard independence and objectivity; breaches of applicable ethical standards; independence and objectivity considerations relating to the provision of non-audit services; and independence and objectivity considerations relating to other matters.

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 partners, Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. 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 are satisfied that our general procedures support our independence and objectivity

Audit independence

Independence and objectivity considerations relating to the provision of non-audit services

Summary of fees

We have considered the fees charged by us to the authority and its controlled entities for professional services provided by us during the reporting period. We have detailed the fees charged by us to the authority and its controlled entities for significant professional services provided by us during the reporting period below, as well as the amounts of any future services which have been contracted or where a written proposal has been submitted. Total fees charged by us for the period ended 31 March 2018 can be analysed as follows:

	2017-18 £	2016-17 £
Audit of the Authority	150,724	150,724
Audit of the Pension Fund	21,000	21,000
Audit of controlled entities	NIL	NIL
Total audit services	**171,724**	**171,724**
Mandatory assurance service (Housing Benefits claim)	27,735	20,423
Audit related assurance services	7,000	7,000
Total Non Audit Services	**7,000**	**7,000**

We are required by AGN 01 to limit the proportion of fees charged for non-audit services (excluding mandatory assurance services) to 70% of the total fee for all audit work carried out in respect of the Authority under the Code of Audit Practice for the year. The ratio of non-audit fees to audit fees for the year was 0.04:1. We do not consider that the total of non-audit fees creates a self-interest threat since the absolute level of fees is not significant to our firm as a whole.

Audit independence

Facts and matters related to the provision of non-audit services and the safeguards put in place that bear upon our independence and objectivity, are set out in the table below:

Description of scope of services	Principal threats to independence and Safeguards applied	Basis of fee	Value of services delivered in the year ended 31 March 2018 £	Value of services committed but not yet delivered £
Audit-related assurance services				
Grant Certification – Teachers Pensions Return and Pooling of Housing Capital Receipts Return Completion of Agreed Upon Procedures in order to certify the return	The nature of these audit-related services is to provide independent assurance on each of these returns. As such we do not consider them to create any independence threats.	Fixed Fee	7,000	7,000
Mandatory assurance services				
Grant Certification – Housing Benefit Subsidy Return Completion of work specified by PSAA to certify the return	The nature of this mandatory assurance service is to provide independent assurance on the claim. As such we do not consider it to create any independence threats.	Fixed Fee	27,735	27,735

Contingent fees

We have not agreed any contingent fees with the Authority.

Appendix 4

Audit independence

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the GARMS Committee.

Confirmation of audit independence

We confirm that as of the date of this report, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Partner and audit staff is not impaired.

This report is intended solely for the information of the Audit Committee of the authority and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

KPMG LLP

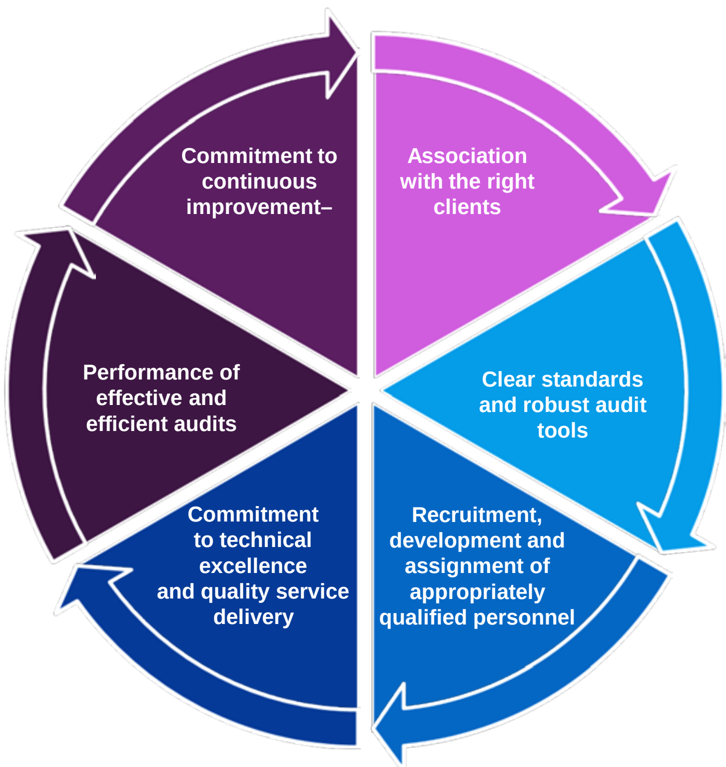
KPMG LLP

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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