



cutting through complexity

Report to those charged with governance (ISA 260) 2014/15

Royal Borough of Kensington and Chelsea

21 September 2015

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission 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 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 Andrew 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, Trevor Rees (on 0161 246 4000, or by email to trevor.rees@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.

This document summarises:

- the key issues identified during our audit of the financial statements for the year ended 31 March 2015 for both the Authority and its Pension Fund; and
- our assessment of the Authority's arrangements to secure value for money.

Scope of this report

This report summarises the key findings arising from:

- our audit work at the Royal Borough of Kensington and Chelsea ('the Authority') in relation to the Authority's 2014/15 financial statements and those of the Local Government Pension Scheme it administers ('the Fund'); and
- the work to support our 2014/15 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

Financial statements

Our *External Audit Plan 2014/15*, presented to you in March 2015, set out the four stages of our financial statements audit process.



This report focuses on the third stage of the process: substantive procedures. Our on site work for this took place during July 2015.

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

VFM conclusion

Our *External Audit Plan 2014/15* explained our risk-based approach to VFM work. We have now completed the work to support our 2014/15 VFM conclusion. This included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion; and
- considering the results of any relevant work by the Authority and

other inspectorates and review agencies in relation to these risk areas.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our audit work in relation to the 2014/15 financial statements of the Authority and the fund.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Acknowledgements

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

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

Proposed audit opinion	<p>We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2015. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.</p> <p>We also anticipate issuing an unqualified audit opinion in relation to the Fund's financial statements, as contained both in the Authority's Statement of Accounts and the Pension Fund Annual Report by 30 September 2015.</p>
Audit adjustments	<p>We are pleased to report that our audit of your financial statements did not identify any material adjustments. The Authority made a number of minor adjustments, all of which were of a presentational nature. There was no impact on the General Fund.</p>
Key financial statements audit risks	<p>We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed all issues appropriately.</p>
Accounts production and audit process	<p>The Authority has strong processes in place for the production of the accounts and excellent quality supporting working papers. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales.</p>
Completion	<p>At the date of this report our audit of the financial statements is substantially complete subject to the completion of our final review procedures and closing procedures.</p> <p>Before we can issue our opinion we require a signed management representation letter.</p> <p>We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.</p>
VFM conclusion and risk areas	<p>We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.</p> <p>We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2015.</p>

We have not identified any issues in the course of the audit that are considered to be material.

We have not identified any issues in the course of the audit of the Fund that are considered to be material.

We anticipate issuing an unqualified audit opinion on the Authority's financial statements, by 30 September 2015.

We anticipate issuing an unqualified audit opinion in relation to the Fund's financial statements, as contained both in the Authority's Statement of Accounts and the Pension Fund Annual Report by 30 September 2015.

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

Proposed audit opinion

We anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Audit and Transparency Committee on 21 September 2015.

Audit differences

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

The final materiality (see Appendix 3 for more information on materiality) level for this year's audit was set at £13 million. Audit differences below £650k are not considered significant.

We did not identify any material misstatements.

In addition, we identified a small number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting in the United Kingdom 2014/15* ('the Code'). We understand that the Authority will be addressing these where significant.

Pension fund audit

Our audit of the Fund also did not identify any material misstatements.

For the audit of the Fund we used a higher materiality level of £16.5 million. Audit differences below £825k are not considered significant.

Subject to final review, we anticipate issuing an unqualified audit opinion following approval of the Statement of Accounts by the Audit and Transparency Committee on 21 September 2015.

Pension Fund Annual Report

We have reviewed the Pension Fund Annual Report and confirmed that:

- the financial and non-financial information it contains is not inconsistent with the financial information contained in the audited financial statements.

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

Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

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

Section three

Financial Statements (continued)

Significant risks and key areas of audit focus

In our *External Audit Plan 2014/15* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. These risk areas were Management override of controls and the Fraud risk of revenue recognition.

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

Areas of significant risk	Summary of findings
 <p>Management override of controls</p> <p>Audit areas affected</p> <ul style="list-style-type: none"> All areas 	<p>Our audit methodology incorporates the risk of management override as a default significant risk. Management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We have not identified any specific additional risks of management override relating to this audit.</p> <p>In line with our methodology, we carried out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.</p> <p>There are no matters arising from this work that we need to bring to your attention.</p>
 <p>Fraud risk of revenue recognition</p> <p>Audit areas affected</p> <ul style="list-style-type: none"> None 	<p>Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.</p> <p>In our <i>External Audit Plan 2014/15</i> we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue.</p> <p>This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.</p>

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

This section sets out our detailed findings on those risks.

In our *External Audit Plan 2014/15* presented to you in March 2015, we identified the significant risks affecting the Authority and the Fund's 2014/15 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

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

Significant audit risk	Issue	Findings
	<p>The Council has a significant asset base primarily relating to Council dwellings, operational buildings and investment property. The potential for impairment/valuation changes makes this balance inherently risky due to the high level of judgement and estimation uncertainty.</p>	<p>To seek assurance that property, plant and equipment is reasonably stated we have performed the following audit procedures:</p> <ul style="list-style-type: none"> • Reviewed management's assessment of property valuations and impairment calculations to gain assurance they are reasonably stated; • Considered the valuer's report and tested to confirm the valuation and accounting entries of the assets valued are correctly stated; • Compared the assumptions made by the valuer to benchmarks for consistency; and • Substantively tested capital additions and disposals for accuracy and completeness. <p>During our testing of disposals it was noted that two assets that had a change of use or had been disposed of in 2013/14 had not been treated appropriately in 2013/14:</p> <ul style="list-style-type: none"> ▪ Munro Mews land; ▪ Holland Park Playgroup land. <p>The Authority had identified the problem and corrected in 2014/15. The value of the assets was not material and therefore a prior year adjustment is not required. Further testing on disposals was performed with no further issues identified.</p> <p>Apart from the matter identified above, we have determined that this significant risk has been appropriately addressed by the Council.</p>

Significant audit risk	Issue	Findings
	<p>LAAP Bulletin 101 <i>Accounting for School Assets used by Local Authority Maintained Schools</i> issued in December 2014 has been published to assist practitioners with the application of the Code in this respect. The challenges relate to school assets owned by third parties such as church bodies and made available to school governing bodies under a variety of arrangements. This includes assets used by Voluntary-Aided (VA) and Voluntary-Controlled (VC) Schools as well as Foundation Schools.</p> <p>Authorities will need to review the agreements under which assets are used by VA/VC and Foundation schools and apply the relevant tests of control in the case of assets made available free of charge, or risks and rewards of ownership in the case of assets made available under leases. This is a key area of judgement and there is a risk that Authorities could omit school assets from, or include school assets in, their balance sheet.</p> <p>Particular risks surround the recognition of Foundation School assets which may or may not be held in Trust. Authorities should pay particular attention to the nature of the relationship between the Trustees and the school governing body to determine whether the school controls the Trust and the assets should therefore be consolidated into their balance sheet.</p>	<p>We have ensured that the Authority is aware of the latest guidance and has reviewed the judgements it has made.</p> <p>We have determined that the Authority has identified all relevant maintained schools within its area and undertaken a review of the agreements underpinning the use of school assets by VA schools.</p> <p>There are 17 Voluntary-Aided schools; none of which have been included in the financial statements for 2014/15. Our testing confirmed this is the appropriate accounting treatment. The Council does not have any Voluntary Controlled or Foundation Schools within its jurisdiction.</p> <p>We have considered the Authority's application of the relevant accounting standards to account for these schools.</p> <p>We have determined that this significant risk has been appropriately addressed.</p>

In our *External Audit Plan 2014/15*, presented to you in **March 2015**, we identified a number of areas of audit focus. These are not considered as significant risks but areas of importance where we would carry out some substantive audit procedures to ensure there is no risk of material misstatement. Given the value of non-payroll expenditures we have added this as an area of audit focus during the course of the audit.

We have now completed our testing. The table sets out our detailed findings for each of the areas of audit focus.

Areas of audit focus	Issue	Findings
	<p>Cash has a pervasive impact on the financial statements and provides comfort for other areas of the financial statements. This area of focus affects the Authority.</p>	<p>We have sought external bank confirmations and reviewed the controls over bank reconciliations. We are satisfied that these controls have operated throughout the year and that the cash figure in the financial statements is materially accurate.</p>
	<p>Pension valuations require a significant level of expertise, judgement and estimation and are therefore more susceptible to error. This is also a very complex accounting area increasing the risk of misstatement. This area of focus affects the Authority.</p>	<p>We have confirmed that the pensions costs and liabilities recognised in the accounts were accurately drawn from the report from the actuary. We have reviewed the accounting treatment for associated balances and transactions in order to confirm that it was in line with the requirements of the CIPFA code. We have not identified any issues to report.</p>
	<p>Payroll and Non-Payroll Expenditures are a material area of the financial statements and an area of focus that affects the Authority.</p>	<p>We have performed substantive test of details and cut-off procedures over Non-Pay Expenditures and have performed substantive analytical procedures over payroll data. No issues were identified from the testing performed.</p>

Our *External Audit Plan 2014/15* also set out our assessment of the risks or other key areas of audit focus on the Pension Fund's financial statements for 2014/15.

We have now completed our testing. The table sets out our detailed findings for each of the areas of audit focus.

Areas of audit focus	Issue	Findings
	<p>From 1 April 2014, all members of the LGPS have automatically joined the new career average defined benefit scheme. The new scheme provides more flexibility on when members can take their pension and also how much they pay in. There is a risk that pension administration systems have not been set up to correctly reflect the changes resulting from LGPS 2014 and will therefore not accurately calculate the pension benefits due to members. While any errors in the system are unlikely to result in material misstatements in 14/15, the possible cumulative effect in future years means that specific audit work is needed on ensuring that the changes required to the system have been accurately reflected.</p>	<p>We reviewed the controls and processes that the Pension Fund have put in place to accurately capture the data required by LGPS 2014. Our work also tested that the system has been set up to accurately calculate future benefit entitlement. No issues were identified from the testing performed.</p>
	<p>The value of pooled investment vehicle assets (<i>Unit Trusts & Managed Funds</i>) totalled £604m at 31 March 2014) is a material item in your financial statements. The current economic climate may put pressure on the health of the Pension Fund, creating a risk that inappropriate valuation methods may be used.</p>	<p>We reviewed the valuation of the Pension Fund investments. No issues were identified from the testing performed.</p>

Financial Statements (continued)

Accounts production and audit process

The Authority has a well established and strong accounts production process. This operated well in 2014/15, and the standard of accounts and supporting working papers was high.

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

Accounts production and audit process

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

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	<p>The Authority continues to maintain a strong financial reporting process and produce statements of accounts to a good standard.</p> <p>We consider that accounting practices are appropriate.</p>
Completeness of draft accounts	<p>We received a complete set of draft accounts on 29 June 2015.</p> <p>The Authority have made a small number of presentational changes to the accounts presented for audit however there have been no changes which we consider to be fundamental.</p>
Quality of supporting working papers	<p>We issued our <i>Accounts Audit Protocol</i> including our required working papers for the audit on 7 April 2015.</p> <p>The quality of working papers provided was high and fully met the standards specified in our <i>Accounts Audit Protocol</i>.</p>
Response to audit queries	<p>Officers resolved all audit queries in a timely manner.</p>

Element	Commentary
Pension Fund Audit	<p>The audit of the Fund was completed alongside the main audit. There are no specific matters to bring to your attention relating to this.</p>

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

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

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

Declaration of independence and objectivity

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

In relation to the audit of the financial statements of the Royal Borough of Kensington and Chelsea and the Royal Borough of Kensington and Chelsea Pension Fund for the year ending 31 March 2015, we confirm that there were no relationships between KPMG LLP and the Royal Borough of Kensington and Chelsea and the Royal Borough of Kensington and Chelsea Pension Fund, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 2 in accordance with ISA 260.

Management representations

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

Other matters

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

- significant difficulties encountered during the audit;
- significant matters arising from the audit that were discussed, or subject to correspondence with management;
- other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the

financial reporting process; and

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

There is only one other matter which we wish to draw to your attention in addition to those highlighted in this report relating to the audit of the Authority's 2014/15 financial statements.

In line with 2012/13 and 2013/14, we identified a minor area for further improvement in relation to segregation of duties concerning journal processing. The finance system does not enforce separate authorisation of journals, although the Corporate Finance team do operate separate authorisation for all closing of accounts related journals. The Authority has addressed this issue with the introduction of the new finance system from 1 April 2015.

We have received a potential objection from a local elector to the 2014/15 accounts which we are currently considering. This may delay the certificate closing the 2014/15 audit.

Implementation of Managed Services

We note that the Managed Services Programme, which is intended to standardise operations and reduce costs across the Royal Borough of Kensington and Chelsea, the London Borough of Hammersmith and Fulham and Westminster City Council, was implemented on 1 April 2015 and there have been some initial problems that had not been foreseen and which are currently being addressed by the Councils. While these issues have not had a direct impact on the 2014/15 audit, we remain alert that there may be an impact on the 2015/16 audit.

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

Background

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

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

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

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

Work completed

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

We have not identified any significant risks to our VFM conclusion, but we considered the delivery of savings plans as an area of audit focus on which we should comment. We have commented on this on page 13.



We did not identify any specific VFM risks but we considered the delivery of savings plans as an area of audit focus on which we should comment.

We are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to this area are adequate.

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

VFM comment	Risk description and link to VFM conclusion	Assessment
	<p>In line with the national picture, the Royal Borough of Kensington and Chelsea are undergoing heavy cuts to government funding at present and are required to make annual savings.</p> <p>The level of savings necessary to cover the funding gap is circa £40.5m between 2016/17 and 2018/19.</p>	<p>Our VFM work focussed on how the Authority is planning and managing its savings plans, 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. For example, that the Plan has duly taken into consideration:</p> <ul style="list-style-type: none"> • salary inflation; • general inflation; • demand pressures; • restructuring costs; and • sensitivity analysis given the degree of variability in the above factors. <p>There is a balanced budget for 2015/16 which includes service savings of £15.5m. The Authority currently estimates that a further £40.5m in savings will need to be achieved during 2016/17 to 2018/19. We are aware the Authority is in the process of developing and agreeing proposals with Members for these future estimated savings.</p> <p>The need for further savings could have a significant impact on the Authority's financial resilience. Consequently, the Authority will need to continue to manage its savings plans to secure longer term financial and operational sustainability.</p>

Conclusion

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

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

Appendix 1: Audit differences

This appendix sets out the audit differences.

Our audit identified only minor presentational improvements.

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

Uncorrected audit differences

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

Corrected audit differences

A number of minor amendments focused on presentational improvements have been made to the draft financial statements.

The Code of Audit Practice requires us to exercise our professional judgement and act independently of both Public Sector Audit Appointments Ltd and the Authority.

Requirements

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

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

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

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

- Details of all relationships between the auditor and the client, its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the client, its directors and senior management and its affiliates, that the auditor considers may reasonably be thought to bear on the auditor's objectivity and independence.

- The related safeguards that are in place.
- The total amount of fees that the auditor and the auditor's network firms have charged to the client and its affiliates for the provision of services during the reporting period, analysed into appropriate categories, for example, statutory audit services, further audit services, tax advisory services and other non-audit services. For each category, the amounts of any future services which have been contracted or where a written proposal has been submitted are separately disclosed. We do this in our *Annual Audit Letter*.

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

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

General procedures to safeguard independence and objectivity

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

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

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

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

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

Auditor declaration

In relation to the audit of the financial statements of the Royal Borough of Kensington and Chelsea and the Royal Borough of Kensington and Chelsea Pension Fund for the financial year ending 31 March 2015, we confirm that there were no relationships between KPMG LLP and Royal Borough of Kensington and Chelsea and Royal Borough of Kensington and Chelsea Pension Fund, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

For 2014/15 our materiality is £13 million for the Authority's accounts. For the Pension Fund it is £16.5 million.

Materiality

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

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

Reporting to the Audit and Transparency Committee

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

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

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

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

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

Materiality – pension fund audit

The same principles apply in setting materiality for the Pension Fund audit. Materiality for the Pension Fund was set at £16.5 million which is approximately two percent of net assets.

We design our procedures to detect errors at a lower level of precision, set at £825k for 2014/15.

Appendix 4: KPMG Audit Quality Framework

We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG.

The diagram summarises our approach and each level is expanded upon.

At KPMG we consider audit quality is not just about reaching the right opinion, but how we reach that opinion. KPMG views the outcome of a quality audit as the delivery of an appropriate and independent opinion in compliance with the auditing standards. It is about the processes, thought and integrity behind the audit report. This means, above all, being independent, compliant with our legal and professional requirements, and offering insight and impartial advice to you, our client.

KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG. We use our seven drivers of audit quality to articulate what audit quality means to KPMG.

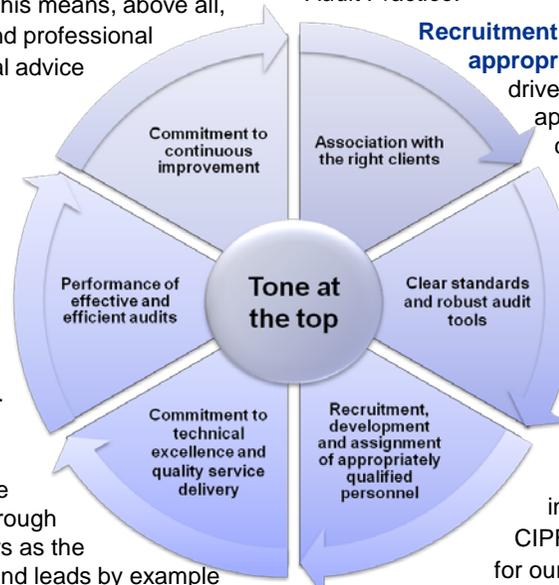
We believe it is important to be transparent about the processes that sit behind a KPMG audit report, so you can have absolute confidence in us and in the quality of our audit.

Tone at the top: We make it clear that audit quality is part of our culture and values and therefore non-negotiable. Tone at the top is the umbrella that covers all the drives of quality through a focused and consistent voice. Andrew Sayers as the Engagement Lead sets the tone on the audit and leads by example with a clearly articulated audit strategy and commits a significant proportion of his time throughout the audit directing and supporting the team.

Association with right clients: We undertake rigorous client and engagement acceptance and continuance procedures which are vital to the ability of KPMG to provide high-quality professional services to our clients.

Clear standards and robust audit tools: We expect our audit professionals to adhere to the clear standards we set and we provide a range of tools to support them in meeting these expectations. The global rollout of KPMG's eAudIT application has significantly enhanced existing audit functionality. eAudIT enables KPMG to deliver a highly

technically enabled audit. All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's *Code of Audit Practice*.



Recruitment, development and assignment of appropriately qualified personnel: One of the key drivers of audit quality is assigning professionals appropriate to the Authority's risks. We take great care to assign the right people to the right clients based on a number of factors including their skill set, capacity and relevant experience.

We have a well developed technical infrastructure across the firm that puts us in a strong position to deal with any emerging issues. This includes:

- A national public sector technical director who has responsibility for co-ordinating our response to emerging accounting issues, influencing accounting bodies (such as CIPFA) as well as acting as a sounding board for our auditors.
- A national technical network of public sector audit professionals is established that meets on a monthly basis and is chaired by our national technical director.
- All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's *Code of Audit Practice*.
- A dedicated Department of Professional Practice comprised of over 100 staff that provide support to our audit teams and deliver our web-based quarterly technical training.

We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

Quality must build on the foundations of well trained staff and a robust methodology.

Commitment to technical excellence and quality service delivery:

Our professionals bring you up- the-minute and accurate technical solutions and together with our specialists are capable of solving complex audit issues and delivering valued insights.

Our audit team draws upon specialist resources including Forensic, Corporate Finance, Transaction Services, Advisory, Taxation, Actuarial and IT. We promote technical excellence and quality service delivery through training and accreditation, developing business understanding and sector knowledge, investment in technical support, development of specialist networks and effective consultation processes.

Performance of effective and efficient audits: We understand that how an audit is conducted is as important as the final result. Our drivers of audit quality maximise the performance of the engagement team during the conduct of every audit. We expect our people to demonstrate certain key behaviors in the performance of effective and efficient audits. The key behaviors that our auditors apply throughout the audit process to deliver effective and efficient audits are outlined below:

- timely Engagement Lead and manager involvement;
- critical assessment of audit evidence;
- exercise of professional judgment and professional scepticism;
- ongoing mentoring and on the job coaching, supervision and review;
- appropriately supported and documented conclusions;
- if relevant, appropriate involvement of the Engagement Quality Control reviewer (EQC review);
- clear reporting of significant findings;
- insightful, open and honest two-way communication with those charged with governance; and
- client confidentiality, information security and data privacy.

Commitment to continuous improvement: We employ a broad range of mechanisms to monitor our performance, respond to feedback and understand our opportunities for improvement.

Our quality review results

Public Sector Audit Appointments Ltd publishes information on the quality of work provided by us (and all other firms) for audits undertaken on behalf of them (<http://www.psa.co.uk/audit-quality/principal-audits/kpmg-audit-quality/>).

The latest Annual Regulatory Compliance and Quality Report (*issued June 2015) showed that we are meeting the overall audit quality and regulatory compliance requirements.



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