# External Audit Report 2018/19

**London Councils**

September 2019

# Content

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This report is addressed to London Councils and has been prepared for the sole use of London Councils. We take no responsibility to any member of staff acting in their individual capacities, or to third parties.

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 Neil Hewitson, the engagement lead to London Councils, who will try to resolve your complaint..

# Important notice

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 London Councils 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.

External auditors do not act as a substitute for London Councils' 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:** This Report is made to London Councils' Audit Committee in order to communicate matters as required by International Audit Standards (ISAs) (UK and Ireland) and other matters coming to our attention during our audit work on the Joint Committee, Transport and Environment Committee and Grants Committee financial statements 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 London Councils' 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 reports. We will provide an oral update on the status of our audit at the Audit Committee meeting. Aspects of our final closedown procedures including final quality review processes and receiving the management representation letters are still ongoing.

# Summary

## Financial statements audit – see section 2 for further details

Subject to the final closedown being satisfactorily completed we intend to issue an unqualified audit opinion on London Councils' Joint Committee, Transport and Environment Committee and Grants Committee financial statements, following the Audit Committee adopting them and receipt of the management representations letters.

We have completed our audit of the consolidated Joint Committee financial statements which comprises the Joint Committee, Transport and Environment Committee, Grants Committee and London Councils Limited financial statements, and the Transport and Environment Committee and Grants Committee financial statements. We have read the Narrative Report and reviewed the Annual Governance Statements (AGS). Our key findings are:

- There are no unadjusted audit differences.
- We agreed one audit adjustment relating to the net pension liability that was made following the McCloud and Sargeant Court ruling and minor presentational changes to all three financial statements with officers.
- We are not seeking any specific management representations beyond those considered as standard for any of the three Committees;
- We reviewed the Narrative Reports and Annual Governance Statements and have no matters to raise.

## Other matters

ISA 260 requires us to communicate 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, etc.).

There are no other matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of London Councils 2018/19 financial statements.

We have made no recommendations as a result of our 2018/19 work. This is similar to the 2017/18 audit.

# Financial statements audit

We audit your financial statements by undertaking the following:

| Work Performed | Accounts production stage: 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 2018/19 audit plan we assessed your operations to identify significant issues that might have a financial statements consequence. We confirmed this risk assessment as part of our audit work. We provide an update on each of the risks identified later in this section. |
| 2. Assessment of the control environment | We assessed the effectiveness of your key financial system controls that prevent and detect material fraud and error. We found that the financial controls on which we seek to place reliance are operating effectively. We reviewed work undertaken by internal audit in accordance with ISA 610 and used the findings to inform our work. |
| 3. Prepared by client request (PBC) | We produced the PBC to summarise the working papers and evidence we ask you to collate as part of the preparation of the financial statements. We discussed and tailored our request with the Chief Accountant and this was issued as a final document to the finance team. We are pleased to report that this has resulted in good-quality working papers with clear audit trails. |
| 4. Accounting standards | We work with you to understand changes to accounting standards and other technical issues. For 2018/19 the key changes related to the implementation of IFRS 9 and 15.<br><br>There were no issues arising from these changes that we need to report to you. |

# Financial statements audit

| | |
|---|---|
| 5. Accounts production | We received complete draft financial statements for all three Committees on 15 July 2019. 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 2018/19.<br><br>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 we identified only minor presentational issues which have been adjusted. |
| 7. Representations | You are required to provide us with representations on specific matters such as your going concern assertion and whether the transactions in the accounts are legal and unaffected by fraud. We provided a draft of this representation letter to the Chief Accountant on 6 September 2019. We draw attention to the requirement in our representation letter for you to confirm to us that you have disclosed all relevant related parties to us. We are not seeking any specific management representations beyond those considered as standard. |

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. 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 annual IAS 19 valuation which was identified as a significant risk within our audit plan;

— The results of our procedures to review the required risks of the fraudulent risk of revenue recognition and management override of control; and

— Our view of the level of prudence applied to key balances in the financial statements.

# Financial statements audit

| SIGNIFICANT audit risk | Account balances effected | Summary of findings |
|---|---|---|
| **All three Committees:**<br><br>Pension assets and liabilities | Net Pension Liability as at 31 March 2019 - Joint Committee:<br><br>Pension assets<br><br>£56.79 million<br><br>PY £52.70 million<br><br>Pension liability<br><br>£83.42 million<br><br>PY £80.72 million<br><br>Net pension liability<br><br>£26.63 million,<br><br>PY £28.02 million | The net pension liability represents a material element of the balance sheet. London Councils is an admitted body of London Pension Fund Authority which had its last triennial valuation at 31 March 2016. This forms the basis of the valuation as at 31 March 2019.<br><br>The calculation of London Councils' pension liability relies on the actuary's methodology and uses financial and demographic assumptions such as the discount rate, inflation rates, mortality rates etc. These assumptions should reflect the profile of the entity's employees and should be based on appropriate data. For pension assets, the main assumptions relate to the rate of return of investments during the year. The basis of the assumptions is derived on a consistent basis year to year, updated to reflect changes.<br><br>There is a risk that the assumptions and methodology used in the valuation of pension assets and liabilities are not reasonable. This could have a material impact to net pension liability accounted for.<br><br>We evaluated the competency, objectivity and independence of Barnett Waddingham, your actuarial expert. We used our KPMG actuarial expert to review the appropriateness of the key assumptions made, compared them to expected ranges and found them to be appropriate. As part of our work we corresponded with the administrating authority to gain comfort over the rate of return estimate used by the actuary (see below). We checked the disclosures in the financial statements were complete and supported by appropriate evidence.<br><br>After London Councils had received their IAS 19 report from Barnet Waddingham that was used to prepare the draft financial statements, the Government Actuary Department reported its methodology to estimate the impact of the December 2018 Court of Appeal judgement in relation to the McCloud and Sargeant cases which related to age discrimination. In addition, on 27June 2019 the Government was refused leave to appeal against this decision which meant that additional liabilities would exist. London Councils engaged Barnett Waddingham to estimate the impact. The outcome was an increase to the pension liability of £575K to the Consolidated Joint Committee accounts and smaller adjustments to the Transport and Environment Committee and Grants Committee. At the same time, Barnet Waddingham reviewed its estimate for the rate of return for the year based on year end figures by c.1% which increased pension assets overall by £425K.<br><br>The financial statements for all three Committees were adjusted accordingly. Our review of the adjustments and assumptions underlying them indicated they were reasonable. We set out our view of the assumptions used in valuing pension assets and liabilities at page 9. |

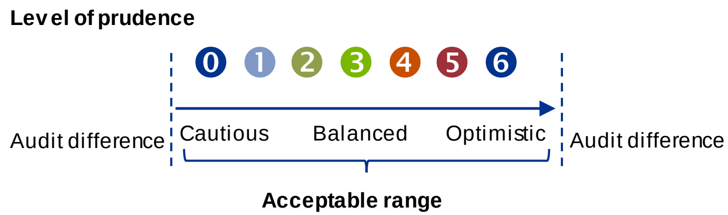
# Financial statements audit

| Risks that ISAs require us to assess in all cases | Why | Our findings from the audit |
|---|---|---|
| **All three Committees**<br>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.<br>We do not consider this to be a significant risk for any of the committee's income as there is unlikely to be an incentive to fraudulently recognise revenue. | There are no matters arising from this work that we need to bring to your attention. |
| **All three Committees**<br>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.<br>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.<br>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** | **CY** | **PY** | **Balance (£m)** | **KPMG comment** |
| Accruals | 3 | 3 | £1.97M<br>PY £1.70M | For each Committee, we agreed a sample of the accruals recorded in the financial statements to supporting documentation, including confirmation of post-year end payment. We reviewed a sample of post-year end payments to check the cut-off of expenditure recorded in the period and ensured there are no unrecorded liabilities at the year end.<br>We believe London Councils assessment for all three Committees represent a balanced view of future payables. |
| Pensions liability | 3 | 4 | £26.63M<br>PY £28.02M | We used our KPMG actuarial expert to review the key actuarial assumptions of discount rate, CPI inflation, salary increases and mortality rates used in the IAS 19 valuation and concluded they are reasonable and were within our expected range of values. In addition we reviewed the rate of return used by Barnet Waddingham, as revised in its updated July 2019 report, and found it to be reasonable.<br>We believe London Councils assumptions for all three Committees represent a balanced view.<br>Last year it was noted there was c.1% difference in the estimated rate of return used and the actual year end position and we assessed the liability as slightly optimistic but within our acceptable range. |

# Financial statements audit

### Narrative Report and Annual Governance Statement

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

### Audit fees

Our fee for the audit was £37,100 excluding VAT (£35,100 excluding VAT in 2017/18). This fee was in line with that highlighted in our audit plan approved by the Audit Committee in March 2019. Our fee for London Councils Limited was £900 excluding VAT (£900 excluding VAT in 2017/18).

We have not performed any non-audit work during the year or in 2017/18.

## Appendix 1

# 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.

Materiality for the Joint Committee consolidated financial statements was set at £1,250K which equates to c.2% of gross expenditure. For the Joint Committee core statements we have used £200K for materiality.

Materiality for the Transport and Environment Committee financial statements was set at £900K which equates to c.2% of gross expenditure.

Materiality for the Grants Committee financial statements was set at £150K which equates to c.2% of gross expenditure.

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

### Reporting to Audit Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any misstatements of lesser amounts to the extent that these are identified by our audit work. Under *ISA 260*, we are obliged to report omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. *ISA 260* defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria. *ISA 450* requires us to request that uncorrected misstatements are corrected.

In the context of London Councils, an individual difference could normally be considered to be clearly trivial if it is less than £62,500 for the Joint Committee overall with £10,000 for its core activities, £45,000 for the Transport and Environment Committee and £7,500 for the Grants Committee.

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

## Appendix 2

# Audit differences

### Unadjusted audit differences

Under UK auditing standards (ISA (UK&I) 260) we are required to provide the Audit Committee with a summary of unadjusted audit differences (including disclosure misstatements) identified during the course of our audit, other than those which are 'clearly trivial', which are not reflected in the financial statements. We are pleased to report that there are no unadjusted audit differences.

### Adjusted audit differences

To assist the Audit Committee in fulfilling its governance responsibilities we present below a summary of non-trivial adjusted audit differences identified during our audit. It is noted that the three adjustments below arose as a result of the Government being refused leave to appeal in the McCloud and Sargeant cases in June 2019 which meant additional liabilities would exist and should be included in the financial statements.

**Adjusted audit differences (£'000) – Consolidated Joint Committee**

| No. | Detail | CIES Dr/(cr) | BS Dr/(cr) | Comments |
|---|---|---|---|---|
| 1 | Dr Cost of Services<br>Cr Other Comprehensive Income and expenditure – actuarial gains<br>Cr Net pension liability | £575 | <br>£425<br>£150 | Adjustment to reflect the impact of the McCloud and Sargeant Court ruling and to update the rate of return used using latest available information. |
| Total | | £575 | £575 | |

**Adjusted audit differences (£'000) – Transport and Environment Committee**

| No. | Detail | CIES Dr/(cr) | BS Dr/(cr) | Comments |
|---|---|---|---|---|
| 1 | Dr Cost of Services<br>Cr Other Comprehensive Income and expenditure – actuarial gains<br>Cr Net pension liability | £176 | <br>£129<br>£47 | Adjustment to reflect the impact of the McCloud and Sargeant Court ruling and to update the rate of return used using latest available information. |
| Total | | £176 | £176 | |

## Appendix 2

# Audit differences

### Adjusted audit differences (Continued)

| Adjusted audit differences (£'000) – Grants Committee | | | | |
|---|---|---|---|---|
| **No.** | **Detail** | **CIES Dr/(cr)** | **BS Dr/(cr)** | **Comments** |
| 1 | Dr Cost of Services<br>Cr Other Comprehensive Income and expenditure – actuarial gains<br>Cr Net pension liability | £22 | <br>£17<br><br>£5 | Adjustment to reflect the impact of the McCloud and Sargeant Court ruling and to update the rate of return used using latest available information. |
| Total | | £22 | £22 | |

There were minor adjustments to the notes to the financial statements, none of which need drawing to the Audit Committee's attention.

# Audit independence

## ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF LONDON COUNCILS

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 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.

### 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 Audit 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 Audit Director and audit staff is not impaired.

This report is intended solely for the information of the Audit Committee of London Councils 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**

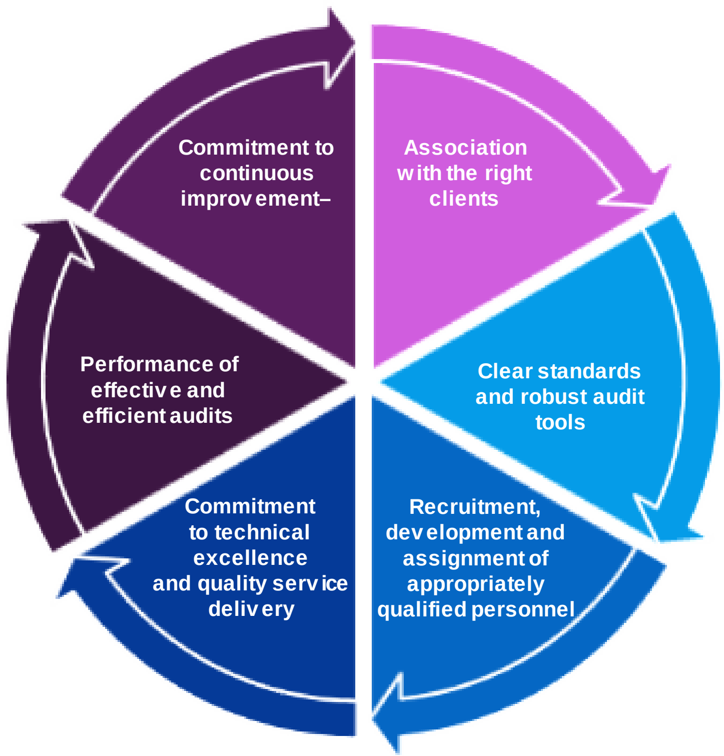
# Audit quality framework

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

- 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

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




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

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

- 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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